policy REVIEW

Spring 1992 Number 60 $4.50

George Bush's Fatal Attraction
Terry Eastland

Tax Revolts and Talk Radio
David Kehler

Conservatism's Avant Garde
Christopher C. DeMuth

EPA's Sins of Emission
Rick Henderson

Abortion Since Jamestown
Marvin Olasky

Defending America on a Half-Billion a Day
How to Trim the Pentagon

Does the GOP Stand for Anything?

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

RECENT HERITAGE FOUNDATION PUBLICATIONS

New Releases

How Privatization Can Solve America's Infrastructure Crisis
Edited by Edward L. Hudgins and Ronald D. Utt
(Critical Issues, 1992, $10.00)

A Prosperity Plan for America, Fiscal 1993
Edited by Scott A. Hodge
(Book, 1992, $15.00)

The Annual Guide to Public Policy Experts
Edited by Robert Huberty and Barbara D. Hohbach
(Book, 1992, $14.95)

Domestic Policy Studies

A National Health System for America
Edited by Stuart M. Butler and Edmund F. Haislmaier
(Critical Issues, 1989, $8.00)

From the Kemp Commission: Sound Advice for Removing Barriers to Affordable Housing
Carl F. Horowitz
(B#848, 1991, $3.00)

For the 1992 publications catalog and latest updates—or to order any of the above—write to:
The Heritage Foundation, Dept. PR60, 214 Massachusetts Avenue, N.E., Washington, D.C. 20002-4999

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Spring 1992

policy REVIEW

Number 60

Editor
Adam Meyerson

Executive Editor
Thomas C. Atwood

Managing Editor
Elizabeth Schoenfeld

Assistant Editor
Tucker Carlson

Administrative Assistant
Jim Rutherford

Subscription Manager
Betsy King

Publisher
Edwin J. Feulner Jr.

Associate Publisher
Burton Yale Pines

Editorial Board
David I. Meiselman, Chairman
Sir Kingsley Amis
George F. Gilder
Stephen Haseler
Harold M. Hochman
Ernest W. Lefever
Shirley Robin Letwin
Henry G. Manne
Antonio Martino
Allan H. Meltzer
Robert Moss
John O'Sullivan
William Schneider Jr.
Gordon Tullock
Ernest van den Haag

Policy Review (ISSN 0146-5945) is published quarterly by The Heritage Foundation, 214 Massachusetts Avenue, N.E., Washington, D.C. 20002-4999. Application to mail at the second-class postage rate is pending at Washington, D.C., and additional mailing offices.

Policy Review is a forum for conservative debate on the major political issues of our time. The views in *Policy Review* are those of the authors. They do not necessarily reflect the views of the editorial board or of The Heritage Foundation.

Correspondence should be sent to *Policy Review*, 214 Massachusetts Avenue, N.E., Washington, D.C. 20002-4999. Telephone: (202) 546-4400. Send requests to reprint more than short quotations to the Executive Editor. Send address changes to *Policy Review*, Subscription Manager, at the above address. Subscription rates are $18 for one year, $34 for two years, $48 for three years. Add $8 a year for foreign air-speeded delivery.

Policy Review is indexed by the Readers' Guide to Periodical Literature, the Public Affairs Information Service, and the Social Sciences Index. *Policy Review* has been copyrighted in 1992 by The Heritage Foundation and is available on NEXIS. U.S.A. Newsstand Distribution by Eastern News Distributors, Inc., 1130 Cleveland Rd., Sandusky, Ohio 44870.

Adam Meyerson 2 **A Case of Elephantiasis**
The Identity Crisis of the Republican Party

David D. Hale 4 **Global Super Market**
The Real Peace Dividend Is Three Billion New Customers

An Interview by Adam Meyerson 10 **Captain of Enterprise**
Christopher C. DeMuth on the Business of Liberty

Terry Eastland 20 **Bush's Fatal Attraction**
Anatomy of the Budget Fiasco

Representative Thomas E. Petri and Bert Ely 25 **Real Taxpayer Protection**
Sound Deposit Insurance Through Cross-Guarantees

Marvin Olasky 30 **Victorian Secret**
Pro-Life Victories in 19th-Century America

David Asman 38 **Wealth of Naciones**
People Power Comes to Latin America

David Kehler 46 **The Trenton Tea Party**
The Story of New Jersey's Tax Revolt

Ted Galen Carpenter, Angelo Codevilla, Aaron Friedberg, William R. Hawkins, Murray Weidenbaum, Dov S. Zakheim 50 **Fighting Trim**
How to Cut the Defense Budget by $100 Billion

Rick Henderson 56 **Dirty Driving**
Donald Stedman and the EPA's Sins of Emission

Spencer Warren 62 **The Lady's Not for Turning**
The Domestic Triumphs of Margaret Thatcher

Bryce J. Christensen 70 **In Sickness and in Health**
The Medical Costs of Family Meltdown

Llewellyn H. Rockwell Jr. 73 **Morning After in America**
The Austrian View of the Recession

Hadley Arkes 78 **Who's the Laissez-Fairest of Them All?**
The Tradition of Natural Rights in American Law

Movie Review 86 The Inner Circle, *directed by Andrei Konchalovsky reviewed by* John V. N. Philip

Letters 88 on Reuben Greenberg, James L. Payne, David Brock, Edwin J. Feulner Jr.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

A Case of Elephantiasis

The Identity Crisis of the Republican Party

ADAM MEYERSON

The Republican Party is suffering its most serious identity crisis since Watergate. Yet it has the potential to build a center-right governing majority that would define American politics for the next generation.

The basis of this majority is the Reagan coalition of economic and social conservatives, expanded by a more racially inclusive and environmentally sensitive message than President Reagan's. The Reagan coalition would be held together by a commitment to tax and spending limitations, and an emphasis on competitive private enterprise, loving families, and active parental involvement in education as the key to making "America first." Military strength, and American leadership on behalf of liberty around the world, are also still winning issues for a center-right majority—though these objectives can be achieved on a substantially lower budget than during the Cold War.

George Bush initially seemed well-suited to put together this kind of majority. He won the 1988 elections by running as a disciple of Reagan with a "kinder, gentler" rhetoric that would appeal to a less ideologically polarized electorate. His "no-new-taxes" pledge and his opposition to protectionism won him support among Reaganites. The message of his inaugural speech—"freedom works"—suggested a pragmatic appreciation of fundamental conservative principles.

The president has gotten in trouble, both within his party and among Democrats and independents who voted for him in 1988, because he has strayed too far from the Reagan economic legacy. Bush remains in the Reagan tradition with his conservative judicial nominations, his opposition to abortion, his Mexico free-trade agreement (one of Reagan's fondest dreams), and his emphasis on peace through military strength and close political and military ties with other leading democracies, including Germany and Japan. But the lesson of the 1992 primaries is that Republicanism cannot simply be defined by a strong defense and a Constitution-based Supreme Court. Questions of economic growth, and of the overall level of taxing and spending, must remain at the heart of any majority coalition.

The president has ignored these questions in two important ways. He has let regulatory agencies and Congress convert his "kinder, gentler" rhetoric into a new wave of regulation that imposes high costs on the economy for uncertain benefits. And his budget agreement of 1990, with its betrayal of his tax pledge, has led to all the consequences that conservatives predicted: an angry electorate, a deeper and longer recession, the Democratic Congress in the driver's seat in domestic policy, and a budget deficit and federal spending at postwar highs as a percentage of national income.

No GOP Domestic Strategy

The president still stands a good chance of winning reelection by default. But Republicans should not take much satisfaction from the difficulties the Democrats have again in fielding attractive presidential candidates. Through their control of both houses of Congress, most state legislatures, and city and county councils, the Democrats remain in charge of almost all the $1.5 trillion that American governments spend on domestic programs. The Republican Party has no current strategy either for limiting this spending or for directing it in ways that would provide better opportunity to the American people.

Indeed the absence of such a strategy explains why so many conservatives and moderates are more interested in term limitations than in ending Democratic control of Congress. With reapportionment, redistricting, and public anger at incumbents, this was supposed to be the year Republicans made major gains in the Congress, especially the House. Instead, the 1990 elections and last year's Thornburgh defeat suggest Republicans in Congress will be lucky to hold their own. Capitol Hill Republicans delivered Bush his key votes on Clarence Thomas, Desert Storm, and the defense budgets that ensured Cold War victory; but they have shared the president's rudderlessness on domestic policy. Conservative enthusiasm for congressional term limits is a vote of no-confidence in a GOP that can't explain why it would do a better job on fundamental taxing and spending issues than George Mitchell and Tom Foley.

The bright spot in the Republican Party is among

ADAM MEYERSON *is editor of* Policy Review.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

governors. Tommy Thompson of Wisconsin, John Engler of Michigan, and William Weld of Massachusetts have limited taxes and spending, and embarked on experiments to deliver government services more cost-effectively—for example, Thompson's voucher plan for low-income students in Milwaukee schools and Weld's efforts to bring Massachusetts health care expenditures more in line with other states. Even so, it is at the state and local level where the Republican Party is weakest—an ironic position for a party ostensibly committed to decentralization. Republicans control fewer than one-third of the nation's state legislative houses, and have ceded most big cities to the Democrats.

Not Getting Money's Worth

To build a governing majority requires an appeal both to Americans' economic interests and to their deepest moral convictions. Two broad domestic themes could do both for Republicans, not just at the presidential level but also in Congress and even local government.

The first is that American taxpayers do not think they are getting their money's worth from government at any level—federal, state, or local. This is the unequivocal message of the tax revolt against Pete Wilson in California, Lowell Weicker in Connecticut, Jim Florio in New Jersey, and George Bush in the White House. Popular support remains high for programs from Social Security to unemployment insurance to food stamps. But taxpayers have told politicians that the federal government should cost no more than 19 to 20 percent of GNP, instead of the current level of nearly 26 percent. They have made similar statements in states across the land, and they have voted with their feet by fleeing cities whose taxes are too high.

Because virtually all spending is controlled by Democratic legislatures, Republicans can put Democrats on the defensive on issue after issue: Why isn't school performance up, with a 20 percent rise in spending per pupil over the past decade? Why are most states paying way over the market rate for work on roads, bridges, and highways? Why is Medicare running out of money after five years of Democratic control of the Congress? Why has the federal budget deficit grown from $150 billion to $400 billion since Democrats gained control of the Senate as well as the House?

The next political majority will have to articulate principles that can appeal to Americans' sense of fair play while bringing spending down to the tax level voters say is proper. These principles could include generosity to those in temporary, unforeseen trouble, but no permanent subsidies for the able-bodied; the expectation that welfare recipients (excepting mothers of pre-school children) should perform work or community service in exchange for benefits; the notion that health insurance should protect families against catastrophes rather than financing routine medical care; and the abandonment of programs that have achieved their most important purposes and therefore outlived their usefulness.

With their strong base in the business world and the upper middle class, Republicans are also in an ideal position to mobilize the private charitable sector in ways that can provide relief to taxpayers. Support for the arts, medical research, and college scholarships are all areas where private nonprofit organizations have a long and distinguished track record. It is an abdication of responsibility among better-off Americans to shunt many of the costs here onto taxpayers. The money is available in the private sector, indeed Republicans could raise it, so there is no reason to think that good programs would suffer if taxpayer support were cut off altogether.

Mobilizing Against Crime

A second broad theme is that every American, male or female, young or old, black or white, should be able to walk without fear on any street and in any school in the land. This is not an unrealistic objective. It has been achieved in Japan, one of whose greatest economic advantages is its absence of crime. From the mid-19th century until recently, it had been achieved in Britain despite a long previous history of unsafe streets. And cities like Charleston, South Carolina, under Police Chief Reuben Greenberg, have shown that dramatic crime reductions are possible in the poorest sections of town without substantial increases in police budgets.

Republicans have rarely made political headway on the crime issue, because their program hasn't gone much beyond capital punishment and tough law enforcement. But while punishing criminals and locking them up is essential in any anti-crime strategy, it is even more important to make crime socially unacceptable by mobilizing the community—churches and mosques, neighborhood "orange hat" patrols, Boy Scouts, volunteer probation officers, Guardian Angels—against violence and thievery. This is something that most local governments, almost universally run by Democrats, have conspicuously failed to do.

Community organizing against crime may well be the best way for Republicans to build support both among lower-income people and among those millions of middle-class Americans who genuinely want to improve life in inner cities and currently incline toward liberal Democrats. It is a children's issue, for fear of violence is probably the single greatest terror among poor children today. It is an economic opportunity issue, for nothing so paralyzes business in a neighborhood as crime against its property, customers, and employees. It is an urban revitalization issue, for millions of middle-class suburbanites, black and white alike, would return to city life if the streets and schools were safer. Ultimately, it is an issue of racial harmony, for nothing so separates black and white America today as the fear of black criminality—a fear that would be allayed by multiracial alliances against crime.

The bitterness many Americans feel toward politicians and politics-as-usual is an excellent opportunity for a party that believes government should be limited. Americans are ready for a message that smaller government is better government, especially if it focuses on goals such as protection against crime, which citizens expect above all from their elected leaders.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Global Super Market

The Real Peace Dividend Is Three Billion New Customers

David D. Hale

The United States and other market democracies are facing their third opportunity of this century to build a more prosperous world economy out of the ashes of international conflict.

The first opportunity came after victory in World War I, and it was thrown away. American isolationism, together with vindictiveness between Germany and France, set the stage for increasing protectionism, economic nationalism, contracting world trade, and ultimately the Great Depression. The collapse of the international market economy encouraged the rise of fascism in Central Europe, Stalinism in the Soviet Union, and imperialism in a Japan denied access to overseas markets.

The second opportunity came after victory in World War II. American and British self-confidence laid the groundwork for an open world economy that produced four decades of steadily increasing world trade and output. Strong institutions such as the General Agreement on Tariffs and Trade (GATT), the International Monetary Fund, the World Bank, and the European Community reinforced the growth of foreign trade and investment, while preventing temporary, regional crises from turning into global catastrophe.

Today, with victory in the Cold War, America and other capitalist leaders face a set of global opportunities and challenges as significant as those after World Wars I and II. Over three billion people in Eastern Europe, the former Soviet Union, China, India, and Latin America are now trying to re-enter the global marketplace for goods and capital for the first time in a half century or more. The question facing America and the West is whether we shall respond to the emerging new economies with the global leadership spirit of the mid-1940s, or the exclusionism of the 1920s.

Building on America's Export Prowess

The opportunities for the United States arising from the emerging global marketplace are extraordinary. During the past five years, the United States has embarked on one of the most remarkable export booms in its history. The American share of world manufactured exports has risen from 14 percent in 1987 to 18 percent in 1991. This boom has paid off in the workplace, as the Commerce Department estimates that every $1 billion of new exports creates 22,000 jobs.

Now imagine the opportunities as three billion potential new customers enjoy a rapid increase in their production and their standard of living. The 400 million people in Latin America have a combined income today of about $1 trillion. Were their per-capita income to rise to Korean standards, Latin America would enjoy a combined GNP of over $2 trillion. As the United States is the major supplier of both capital and consumer goods to many Latin American countries, such a doubling of their incomes would provide a major boost to U.S. exports.

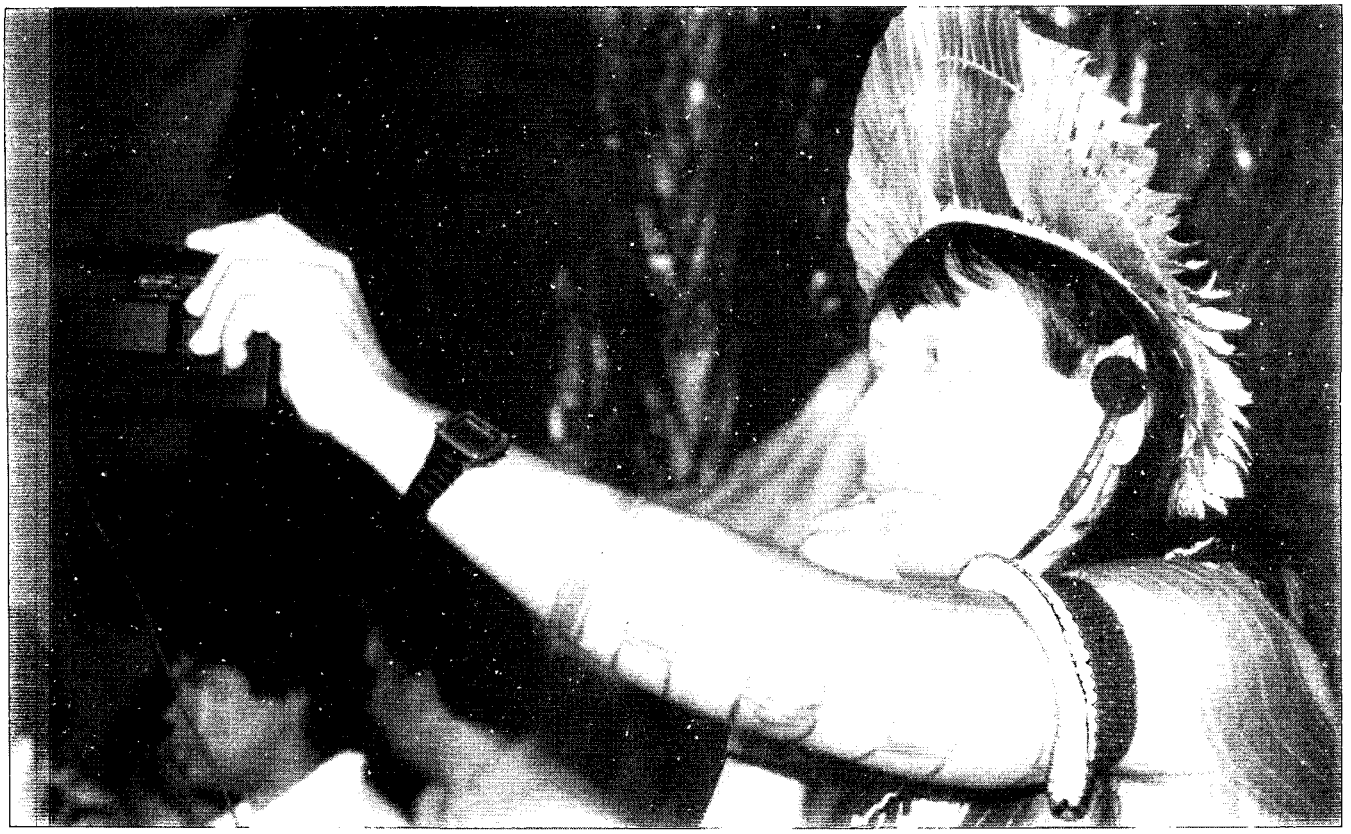
Imagine, too, if China were to continue on the 9-to-10 percent annual growth path that it has enjoyed since the 1980s. At this pace, China in the year 2015 would boast a GNP as large as Japan's today. Japan is our second largest export market, and last year bought some $50 billion in U.S. goods and services, thereby giving jobs to over one million Americans. The emergence of a comparable market in China would provide even greater trade opportunities.

Slump in Real Wages

The American people seem to be facing this new world of opportunity, however, in a mood of apprehension and anxiety. Soured by the longest period of sluggish growth since World War II, by the worst banking crisis since the Great Depression, and by continued high if declining trade deficits, many Americans see only the risks and challenges of the new global marketplace. They increasingly regard the international economic system as a zero-sum game in which rising production and exports from other countries pose a threat to America's employment security, living standards, and cost of capital. Last year many congressmen opposed negotiating a free-trade agreement with Mexico on the grounds that it would produce large job losses in low-wage industries. Presidential candidates in both parties this year have tried to play on popular fears of Japan by promising more import restrictions or greater government intervention

David D. Hale *is chief economist and senior vice president of Kemper Financial Companies in Chicago.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED



Reuters/Bettmann

Amazon Audiophile. Imagine all the customers for American exports as three billion Russians, East Europeans, Chinese, Indians, and Latin Americans enter the world market for the first time.

to protect the U.S. economy from foreign competition.

So long as the U.S. economy is in recession, there will be no simple way to calm the anxieties of the American people about their place in the new world order. The 1991-92 recession has resulted from the interaction of two powerful forces—a 20-year slump in productivity and real wage growth, overlapping with a cyclical unwinding of the greatest leverage boom in modern American history. Since the OPEC oil price shock of the early 1970s, the growth rate of American productivity has slumped to barely 1 percent for the whole economy. Real wages for many categories of workers have stagnated or shrunk.

In the 1980s, the effects of this erosion of real wages on consumption were offset by tax cuts, large increases in consumer borrowing, and a steady expansion in the percentage of women employed outside the home. In fact, the consumption share of GNP rose to the highest level in American history. But since 1989 there has been a sharp slowdown in both public and private borrowing that has exposed America's structural problems in generating real wage growth. Indeed many Washington officials quietly admit that the U.S. economy's long-run growth rate may now be only 2-to-2.5 percent, compared with well over 3 percent during the 1950s and 1960s.

Legacy of Overlending

The growth rate of private borrowing fell sharply after 1989 because many sectors of the economy could not absorb any more debt while the banks experienced a steep rise in their stock of non-performing loans. The banking crisis has resulted from the massive expansion in property lending during the 1980s. Overly generous depreciation laws early in the decade, coupled with lax federal oversight of bank lending, encouraged banks to increase vastly their exposure to commercial real estate development. Commercial property loans doubled during the second half of the decade, leading to such a sharp rise in office construction that many cities now have commercial vacancy rates of 20 percent.

The resulting upsurge in non-performing property loans has extinguished over one-quarter of bank equity capital in New England and significantly weakened the balance sheets of leading banks in New York and California. In turn, the erosion of bank capital has significantly weakened the economy's ability to respond to falling interest rates. Whereas money was expensive but easily obtained in the 1980s, it is now cheap but severely rationed. Large corporations have no problem obtaining funds from the securities markets, but credit is hard to come by for commercial real estate and, more generally, for many small businesses.

Meanwhile, it is difficult for the administration to pursue as expansionary a fiscal policy as previous administrations have done during recessions because of the near tripling in government debt that occurred during the 1980s. More than two-thirds of the projected $400 billion budget deficit in fiscal year 1992 consists of interest payments and bank bailouts. Such a deficit is less stimulative than a deficit financing tax cuts and higher defense spending. But the sheer scale of the debt expansion in the 1980s guaranteed a period of consolidation

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

during the early 1990s. The same retrenchment can be seen in other developed countries (Britain, Canada, and Australia) that experienced financial deregulation, much more aggressive bank lending, a dramatic expansion of private borrowing, and asset inflation during the 1980s.

Bush's Ambitious Trade Agenda

Despite the short-term debt constraints on growth, the opportunities created by the end of the Cold War offer extraordinary hope. Although President Bush has so far been unable to articulate a compelling vision of these opportunities, his administration has pursued one of the most ambitious trade-opening agendas of any modern presidency. The president has started serious negotiations with Mexico over a free-trade agreement and has offered a framework for more comprehensive trade with the rest of Latin America. He has attempted to resolve sectoral trade disputes with China, while keeping the door open and thus encouraging China to become a more important participant in the world market. Despite some highly visible mistakes on his recent trip to Japan, he has by and large pushed for microeconomic changes within Japan that would open the import market there, including liberalization of the retail laws and more rigorous antitrust policies. And the administration has been firmly committed to further GATT agreements, despite the resistance of France and other European countries to agricultural reform.

Will America respond to the new market economies with the global leadership spirit of the mid-1940s or the exclusionism of the 1920s?

Trade policy, however, is only one small part of the policy challenge during the next quarter-century, as the United States and other industrial nations seek ways to accommodate the entry of three billion people into the global marketplace for goods and capital. The expanding world economy will offer America falling consumer prices at home and billions of new customers abroad, but it will also offer international competition even more vigorous than that of the past 20 years. This will require major transformations of labor and education policy, lest millions of Americans fall by the wayside. And it will require a major increase in national savings, as competition for capital is likely to become more intense.

Safety Nets for the Low-Skilled

One challenge of these new economies will be a great increase in the supply of agricultural commodities, minerals, and low-value-added manufactured goods on international markets. Before 1914, Russia was the breadbasket of Germany and the world's largest exporter of petroleum. Today its agricultural productivity is less than one-third of America's and it often has to import food. But under a market economic system, it could re-emerge as a major supplier of many foodstuffs while offering a well-trained low-cost labor force for manufacturing. The same potential exists in Eastern Europe, China, and Latin America. India, meanwhile, is a sleeping giant. During the 1980s, India, with 850 million people, exported less than did Hong Kong, with six million people. But India will be a major power on world markets if it shifts from protectionism (average tariff in the 1980s: 118 percent) to an export orientation.

As in the 19th century, a large rise in world output from new regions of production will restrain inflation and boost the living standards of consumers in importing countries. It will also cause hardship for many existing producers. When world agricultural supply exploded in the 1880s and 1890s, prices fell so sharply that many primary-producing countries regarded the era as a period of depression. France and Germany imposed tariffs on grain to protect their farmers, while American farmers sought to raise domestic agricultural prices by devaluing the dollar. Italy adjusted to the decline in farm prices by exporting millions of its rural people to Argentina and the United States.

So, too, in the years to come, American farmers could suffer from declining commodity prices as world agricultural output rises. The wages of less-skilled industrial workers could be hurt by low-cost manufactured imports. Harvard's Richard Freeman has shown that the income level of less-skilled U.S. workers fell by 11 percent relative to that of college graduates in the 1980s, with rising imports and immigration accounting for 15 to 25 percent of this decline. Further declines of this magnitude or greater can be expected, unless retraining and vocational education policies are established to greatly enhance Americans' skill levels.

To win congressional fast-track authority for the U.S.–Mexican free-trade agreement in 1991, the Bush administration offered special retraining programs for workers whose jobs might be lost because of the FTA. This compromise is a model for promoting America's adjustment to shocks arising from the return of other state-based economies to the world marketplace. In addition, higher standards for elementary and secondary education will be necessary across the country, especially in those states and school districts where educational achievement is already inadequate for the rigors of international competition. America may also want to consider the suggestion of former Trade Representative William Brock to create industrial apprenticeship programs comparable to those that have long existed in Germany.

Competition for Capital

The second challenge posed by the new world economy will be potentially greater competition for capital. As the newly marketized economies privatize companies and create stock and bond markets, they are gaining renewed access to bank lending and making

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

themselves more attractive for foreign direct investment. Unless there is a rise in the global savings rate, this burst of new investment opportunities could raise world real interest rates in the middle and late 1990s.

Already there are over 30 stock markets in the developing world with a total capitalization of $470 billion. While most of this new capitalization is in East Asia, the value of the Mexican stock market has mushroomed from $20 billion in 1989 to over $65 billion today. Investor interest is growing elsewhere in Latin America as well as South Africa and South Asia. The creation of viable bond and equity markets in these countries will enable them to tap into the huge savings pools controlled by pension funds and insurance companies in North America, Europe, and Japan.

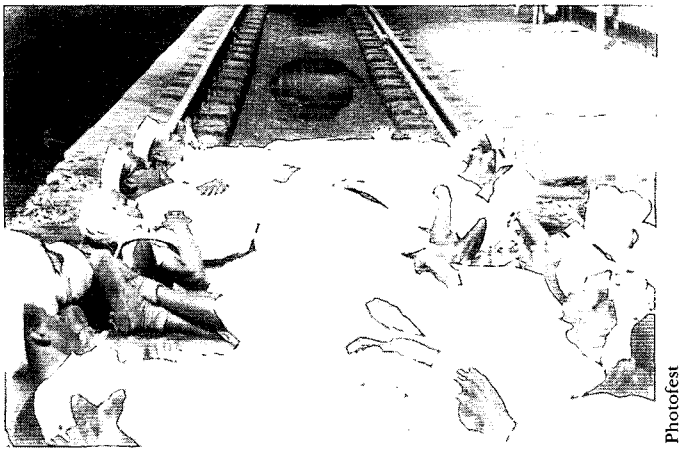
The market economic revolution will also make developing countries more attractive for foreign direct investment (FDI). Developing countries accounted for only $18 billion of the $185 billion in FDI in 1989. More than half of this investment went into the United States and Great Britain, whose open asset markets facilitated takeover bids by foreign firms. As developing countries open their asset markets, they should expand their share of direct investment flows, including corporate takeovers.

The problem for the United States and other industrial countries is that the growth of investment opportunities in the new market economies is occurring at a time of falling savings rates. National savings rates of the leading industrial nations averaged only 20 percent in the 1980s, compared with 23 percent in the late 1970s and 24 percent in the six years before the 1973 oil shock. If the industrial world's savings rate were still 24 percent, it would have an additional $400 billion of capital available for investment every year.

A large rise in world output from new regions will restrain inflation and boost American living standards.

The decline in these savings rates resulted from a sharp rise in government deficits and a small decline in private savings. The biggest dis-savers between the 1960s and the late 1980s were Japan, where the private savings rate fell from 30 percent of GNP to 26 percent; France, where the government surplus fell from 4.8 percent of GNP to 1.4 percent; Germany, where the government savings rate dropped from 5.3 percent to 1.9 percent; and Italy, where the government deficit grew from 1.2 percent of GNP to 6.4 percent.

The United States also contributed to this dis-saving trend through its expanded government deficit. But the net swing in U.S. national savings was smaller than elsewhere because the U.S. entered the 1980s with the lowest savings rate of the leading industrial nations. After World War II, Europe and Japan skewed tax and regulatory policies toward savings to finance reconstruction. The United States did not feel compelled to introduce such policies and thus never experienced the surge in savings rates that occurred in the other industrial countries in the 1950s.



Photofest

India, with its 850 million people, is a sleeping giant on world markets.

An American Savings Agenda

In a world of capital shortage, it will be more difficult for the United States to offset its low domestic savings rate than it was in the 1980s. Then the U.S. had no problem importing capital, as it was the world economy's primary growth engine by default. But in the coming decade, the United States will be one of many countries seeking foreign investment. In 1991, U.S. interest rates fell due to the recession in domestic spending, but in 1993 they could rise sharply if there is no adjustment in government borrowing or private savings to offset a recovery in investment.

More worrisome is that, even with a rise in interest rates, investment rates in the United States will remain too low to boost productivity growth substantially. At 25 percent, the Japanese fixed investment share of GNP is almost double America's, while Germany's at 20 percent is about one-third higher. World financial markets are not yet completely integrated, as there are still many barriers to capital mobility for large pools of institutional savings. In the United States most pension funds and insurance companies still invest only about 5 percent of their assets overseas, while in Britain and Japan the upper limit ranges between 20 and 30 percent. Many corporations also give first priority to domestic over foreign investment. A country's savings rate is still an important determinant of its investment rate and, hence, of its potential economic performance. Importing from abroad can only go so far: As Simon Kuznets has estimated, the capital imports of rapidly industrializing countries have exceeded 4 percent of GNP in only one decade (1902–1913) during the past century.

A U.S. growth path higher than the current expected trajectory of 2 to 2.5 percent per year therefore requires a boost in national savings. Some increases in savings are likely to take place simply because banks will be more

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

UPI/Bettmann

America can no longer afford the lowest savings rate in the industrial world.

cautious in lending, and thus will demand higher down payments for homes and durable goods. The aging of the population also could give a gradual boost to household savings during the next decade. In the 1980s there was a sharp rise in the population of young adults borrowing to establish households for the first time. In the 1990s there will be a sharp rise in the middle-aged population. As families mature, savings rates typically rise in preparation for retirement. Household savings are already in the 5.5-to-6-percent of income range, compared with a trough of 4 percent in the 1980s.

But these demographic forces will have to be supplemented by public policy changes. High on the list would be a sharp reduction in the federal deficit, which, according to the Congressional Budget Office, will stand at 3 percent of GNP even when the economy recovers. Military spending, of course, will probably be able to come down. The president and Congress will have to make fundamental decisions about reforming health care financing to reduce its burden on the private sector as well as the federal treasury, and to reduce the domestic discretionary spending programs that were trimmed in the Reagan years but have been growing rapidly under Bush. There will also have to be a far-reaching debate about entitlements and their effect on competitiveness.

Another important policy change would be reforms in the tax system to favor savings. During the 1980s the United States was the only industrial country to slash marginal income tax rates without hiking consumption taxes in order to offset the revenue losses. As a result, the federal government depends more heavily on income taxes than the central governments of other market economies. Although it has the lowest housing costs in the free world, the U.S. is the only industrial country to provide large tax allowances for mortgage interest without any income test. The United States is also unique in not providing allowances to corporate shareholders for taxes paid at the corporate level.

The current tax structure thus depresses national savings in two ways. American families are encouraged to borrow on a far larger scale than the household sectors of other countries. And American corporations, especially in the 1980s, aggressively converted equity into debt to avoid double taxation; in so doing, they ate into retained profits, an important source of national savings, in order to expand interest payments to bondholders. The U.S. Treasury recently completed a *two-year* study of the need to improve the tax treatment of equity, but it was not followed up by any substantive policy proposals or even an endorsement by Treasury Secretary Nicholas Brady. A government truly alarmed by the country's low level of savings and investment would slash tax subsidies for mortgage borrowing, use the revenue gains to level the fiscal playing field between debt and equity, and cut the total public-sector deficit with higher consumption taxes.

Going on Offense

In the final stages of World War II, the Allied powers organized the Bretton Woods conference to discuss the shape of the international economic order that would follow the war. As the Cold War has ended without a peace conference, however, no single event has focused popular attention on the full scope of the global economic reconstruction challenge that lies ahead. Therefore many of the issues that were once addressed at Bretton Woods are now being re-examined on an *ad hoc* basis through the GATT, the IMF, the World Bank, and the G-7 conference of finance ministers and heads of government. But as the protectionist tone of America's election campaign, France's strident opposition to food imports from Eastern Europe, and the stalling of the GATT talks will testify, this piecemeal approach does not appear adequate to overcome the entrenched domestic support in key industrial countries for restrictive trade policies. Nor is there any forum to discuss the relationship between expanding investment opportunities and the need for higher savings rates around the world.

Given the extraordinary opportunities that lie ahead, it is thus in the interest of the United States to support a multilateral conference to discuss global economic reconstruction after the Cold War. Such a conference would have to overcome many of the same sectoral disputes and regional tensions as the current GATT talks and could easily get bogged down. But because the focus of the conference would be the reintegration of the former Marxist and mercantilist economies into the global marketplace for goods and capital, it would provide governments in Paris, Tokyo, Washington, and elsewhere with more compelling arguments to accept radical changes in their trade and savings policies than GATT alone has been able to do.

The cause of an open world economy requires its proponents to go on offense instead of playing defense. A multilateral conference of this sort could excite popular opinion about the tremendous opportunities created by the end of the Cold War. The challenge for Americans, Europeans, and Japanese is how to accommodate three billion new customers in the global marketplace while developing training and education safety nets for the workers and farmers of the old industrial world—thus insuring their support of global economic integration during the 100-year transition to uniformly high living standards for all mankind. ☎

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE BOARD OF DIRECTORS
OF THE MONT PELERIN SOCIETY

announces the

Olive W. Garvey Fellowships

for the

1992 GENERAL MEETING
OF THE MONT PELERIN SOCIETY
(Vancouver, British Columbia - August 30 - September 4, 1992)

The Garvey Fellowships will be awarded for the three best essays on the topic

'MARKETS IN THE POST-COLD WAR ERA: CONTROLLED OR FREE?'

Essays of not more than 5,000 words may be submitted by students or young faculty members 35 years of age or younger, who are not members of the Mont Pelerin Society.

The essays will be judged by a panel of three senior members of The Mont Pelerin Society. Deadline for submission of essays is 15 May 1992.

First prize Garvey Fellow Award of $2,500 + $1,000 travel grant to participate in the Society's Vancouver meeting.

Second Prize Garvey Fellow Award of $1,500 + $1,000 travel grant to participate in the Society's Vancouver meeting.

Third Prize Garvey Fellow Award of $1,000 + $1,000 travel grant to participate in the Society's Vancouver meeting.

Further information is available from:
The Mont Pelerin Society
P.O. Box 7031
Alexandria, Virginia 22307, USA

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Captain of Enterprise

Christopher C. DeMuth on the Business of Liberty

An Interview by Adam Meyerson

After several years of ideological indirection and financial instability, the American Enterprise Institute has regained its footing as one of America's leading conservative public policy research organizations. The turnabout has come under the direction of its president since 1986, Christopher C. DeMuth, a University of Chicago-trained lawyer with a strong background in the law and economics movement who was head of the White House regulatory office in the first Reagan term. In February 1992, DeMuth talked with *Policy Review* editor Adam Meyerson about the economic achievements and failures of the Reagan and Bush administrations, AEI's research agenda on behalf of the free economic and political order, and relations between the business community (with which AEI has strong ties) and the conservative political movement.

Policy Review: **You've argued that, with the fall of the Soviet empire, "the decisive moral contest in our future is between democratic capitalism and socialism." What is the nature of this contest? Who is the enemy?**

DeMuth: Socialism is the idea that government can usefully organize the lives of individuals toward some social purpose—whether it be better and cheaper health care, or the elimination of poverty, or the preservation of the family farm. However noble the purpose may be, it is rarely achieved by government because people have purposes of their own and adapt to government policies in ways that compromise or defeat them, and because interest-group pressures skew government programs to the groups' purposes at the expense of others. These difficulties afflict all government programs, including "night-watchman state" functions such as defense and law enforcement, but they become much more serious as the ambitions and size of government increase and as it attempts to regiment private markets and the internal affairs of social and economic groups.

Today Communism has been defeated and avowedly socialist parties are on the defensive. Yet the idea of limited government, which was central to the American Founding and the first century and a half of our history, remains alien to modern politics. It has been decades since a mainstream politician rose in the Congress to oppose a new spending or regulatory program on the simple ground that it was beyond the constitutional or prudential bounds of government. The reigning spirit is political pragmatism, which regards government as a neutral or beneficial force rather than as a deeply problematic enterprise and which treats all questions of policy as matters of case-by-case political calculation. This pragmatism is endlessly amenable to new extensions of government, yet incapable of understanding why government projects so often go amiss except in terms of corruption, sloth, or stupidity. The result is that government and popular disillusionment with government grow in tandem—a very unhealthy situation.

Now the moral and philosophical arguments for limited government are tremendously important and need to be pressed at every opportunity. But I also think that policy research organizations such as AEI and Heritage need to adopt for purposes of argument the pragmatic spirit of the age. We need to demonstrate empirically—in a way that will be convincing to those who do not share all our philosophical premises but do believe in "the facts"—the actual effects of particular government policies and to show how well-intentioned policies systematically miss the mark due to compensating private behavior and interest-group politics. And we need to show how the economic or social circumstances that are said to call for government action are frequently exaggerated, self-correcting, or no worse than the government-prescribed cure—again as a matter of factual argument rather than overriding principle.

P.R.: **Is the growth of government an inherent feature of democratic politics? Or are there important constraints that can at least contain socialism, if not roll it back?**

DeMuth: The success of tax-limitation politics during the Reagan years in Washington and at the state level from California to New Jersey suggests there may be a "political maximum" of average tax rates. Tax limitation is, however, a very imperfect tool for limiting government when the government has so many other means

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

of financing its activities—borrowing, printing money, and "mandated benefits" and other forms of regulation.

Some striking recent research by Sam Peltzman of the University of Chicago concludes that voters tend to punish public officials who increase government spending rather than those who increase taxation. This research suggests that voters understand that whatever the government spends it eventually taxes one way or another, but it also suggests that politicians have behaved irrationally over extended periods of time. Perhaps the recent resurgence of conservative politics shows that pragmatic politicians have anticipated Peltzman's research. Over the past decade popular, anti-establishment movements in the United States, Britain, New Zealand, Sweden, and elsewhere have constrained the growth of government and even cut back on transfer payments, subsidies, and state ownership of industries.

The growth of international commerce and finance is also working to limit the growth of government. As business firms find it easier to relocate their activities away from relatively high taxes and regulatory impositions, nations lose effective jurisdiction. I was struck, for example, that after the stock market crash of October 1987, the U.S. Congress and regulatory agencies did almost nothing to "fix the problem" despite a good deal of huffing and puffing. The traditional response to an event of this magnitude would have been a welter of new laws and regulatory controls; I think the principal reason for forbearance was that it was evident that new compliance costs and trading restrictions would have promptly driven U.S. trading business to exchanges in London, Tokyo, and elsewhere.

The political effects of the growth of international markets are not, however, one-sided. Where international trade threatens the policy discretion of individual governments, the governments respond by restricting trade or forming "policy cartels." There is a good deal of this in the movement toward economic and political integration in Europe. Similarly, governments and environmental groups are giving greater prominence to international environmental issues as it becomes more difficult for individual nations to pursue costly environmental policies unilaterally.

P.R.: **You've suggested that an underlying reason for the growth of government may be the emergence of a "middle-class populism" that favors government subsidy as a way of keeping down costs of education, health care, housing, and other important goods and services.**

DeMuth: With the general growth of education, income, and wealth in most of society, one of the most important traditional sources of the growth of government—redistributive politics—has lost much of its emotive force. It has been replaced by efforts to provide new governmental benefits for people who are fairly solidly middle class but who may be persuaded to regard themselves as belonging to a particular group—consumers of some good or service, members of a certain age group, members of a certain racial group, or as single versus married versus married with children. No longer do we see the Democrats standing up for the union man versus the Republicans standing up for management. Instead, both parties are now competing for the affections of the middle class by promising that health care or auto insurance or housing can be provided better or more cheaply if government provides or guarantees or subsidizes it. The federal budget is now largely devoted to middle-class subsidies of one kind or another, most prominently medical care and retirement income but also a profusion of narrower ones such as student loans and farm subsidies.

American Enterprise Institute

Christopher C. DeMuth: With the fall of the Soviet empire, "the decisive moral contest in our future is between democratic capitalism and socialism."

It is all an illusion: there are not remotely enough rich people to subsidize the middle class, and the poor pay almost no taxes and no one is suggesting they should. So it is just the middle class subsidizing itself—people who are pretty much alike economically, but who are encouraged by politicians of both parties to think of themselves as elderly or young, as parents or children, as medical patients or students or homeowners, rather than as people who are all or most of these things at one time or another. At some point a political leader is going to come along with the wit to point out that we cannot all grow wealthier by picking each other's pockets, but for the time being the preservation of this illusion is a bipartisan project and virtually all politicians believe their careers depend on preserving and extending it.

The failure to stop the growth of middle-class self-subsidy was the single greatest missed opportunity of the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Photofest

"Most government expenditures consist of the middle class subsidizing itself. But we cannot all grow wealthier by picking each other's pockets."

Reagan years. This failure was based on a misreading of the political reaction to President Reagan's disastrously ill-conceived Social Security reform proposal at the beginning of his first term. The political blunder was not to propose reforms to Social Security, but to propose reductions in benefits to people who were already retired or about to retire.

It is true but irrelevant that current Social Security benefits are far greater than the value of the payments made by those who are now receiving benefits. The relevant fact is that retirees expected a certain level of retirement benefits and planned their affairs accordingly—upsetting these plans is a violation of social contract. But imagine if someone were to propose adjusting benefits far in the future, so as to maintain Social Security as a reliable safety net but not as a guarantee of a high level of retirement income. The political consequences could be very different. I do not think those who would be affected by such a change—say those who are now 45 years old—would react strongly against it. They have plenty of time to adjust, and many of them realize that the current rate of increase in benefits is demographically unsustainable, given the much smaller cohorts following the baby-boomers. Just ask around the office how many people in their 40s think their Social Security benefits are going to be as generous as those of their parents. Formally acknowledging and accommodating this reality now, rather than waiting until a major funding crisis is upon us 20 years from now, would be good policy—encouraging private saving and avoiding inequities between those who are more and less politically sophisticated.

***P.R.:* You've said that the purpose of the American Enterprise Institute is "to do battle, in scholarship and intellectual debate, on behalf of the free economic and political order." What are your current research priorities?**

DeMuth: At AEI we try to adopt a longer time horizon than the legislator, executive branch official, or journalist, but to stay much closer to practical policy issues than a purely academic research institution. We attempt to look beyond the immediate political fray and anticipate which issues will be important three or four years out—time enough for us to prepare useful, original research that will make the ensuing debates more informed, less polemical, and more productive. If an issue is being teed up at the Ways and Means Committee next Tuesday afternoon, it is too late for AEI to get into it.

Of course, if we're successful at this we will have a good deal to say about current controversies at any point in time. AEI scholars are routinely consulted on current policy issues and frequently testify before congressional committees, write newspaper "op-ed" pieces, appear on

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

television public affairs programs, and so forth. But ideally these contributions are the tips of large, longstanding icebergs of research.

In defense and foreign affairs, our chief priority is to help define a new set of principles and purposes for American foreign policy in the post-Cold War era—where the United States will have fewer outright enemies but also fewer staunch allies, where the military and economic threats to American interests are much subtler than they have been, and where traditional notions of national sovereignty are losing ground to transcendent ideals of human rights and democratic self-government. An immediate focus in the military sphere is on the paradox of superpower disarmament combined with weapons proliferation in what used to be called the Third World, and the consequences of the diffusion of nuclear and other weapons technologies.

In domestic policy our work is concerned with economic growth, social welfare, and the vitality of American culture and political institutions. The central task of economic policy is to revive the growth in productivity that was characteristic of the U.S. economy for most of the 20th century but has slowed dramatically since the early 1970s, with harmful effects not only on economic progress but on American optimism. If Americans are less confident than we used to be that our children will be better off than we are as a matter of social progress as well as individual pluck, we are accurately reflecting two decades of slowdown in productivity growth. This slowdown is not inevitable. On the contrary, advances in technology and the growth of world markets could yield even greater progress than in the past.

We are devoting particular attention to two areas of economic policy. The first is health care, retirement income, and labor market policies. For all the current talk about expanding federal health care programs, the largest existing program, Medicare, will be insolvent in a decade or so; the long-term prospects of our Medicare and Social Security programs are much larger fiscal issues than the year-to-year budget deficits that receive so much more attention in Washington. And in the meantime, various tax and "mandated benefits" policies make it more expensive to hire people even as economic change makes labor mobility more important.

The second is a revival of the deregulation movement. Great progress was made in this area in the 1970s and 1980s, drawing on important research produced at AEI and elsewhere. More recently the reformist spirit seems to have left regulatory policy, and state and federal regulation has been growing rapidly again. Our work here will focus heavily on deregulation where obsolete policies are imposing particularly heavy costs in the form of suppressed innovation—broadcasting and communications regulation, financial market regulation, and food and pharmaceutical regulation—and on reform of environmental regulation. Environmental reform means the adoption of reasonable rather than fanatical risk-reduction goals, and the use of markets and economic incentives for achieving these goals. I see great potential for improvement in both areas; current environmental policies have become so extravagantly wasteful that even some of the environmental groups have come to understand the possibilities of environmental as well as other economic gains from reform.

Probably the most distinctive focus of AEI's work is the social and political foundations of the free society and "democratic capitalism." Much of our best work and many of our best-known people—Michael Novak, Irving Kristol, Robert Bork, Dinesh D'Souza, Ben Wattenberg, Suzanne Garment, and others—are concerned with the health of America's cultural, educational, and social institutions. Doug Besharov, Nick Eberstadt, Charles Murray, and Karl Zinsmeister are working on the difficult issues of child and family welfare and the effects of government welfare policies. Karlyn Keene, Norman Ornstein, and William Schneider are producing important new work on changes in the American electorate and parties and on proposals for political and congressional reform.

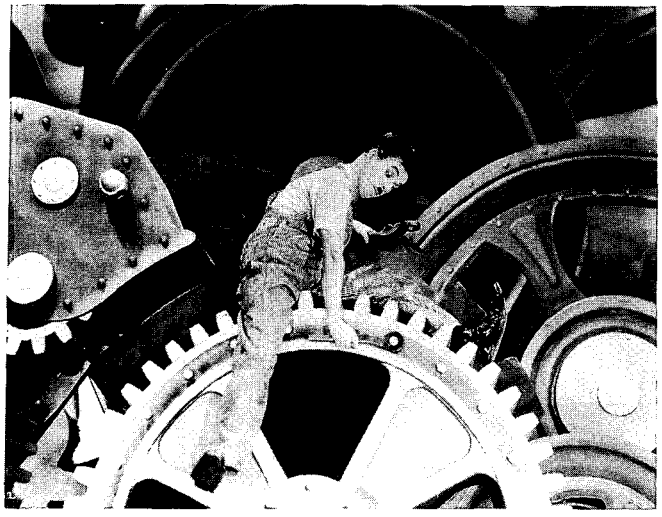
P.R.: **Economic growth has been slower under George Bush than in the first three years of any recent presidency. To what extent do the recession and sluggish recovery result from Bush's tax and regulatory policies, to what extent from policy mistakes of the '80s, and to what extent from a natural and inevitable unfolding of the business cycle?**

DeMuth: The current recession has been relatively mild by postwar standards; certainly it is mild compared with that of 1981–82. But it has coincided with a substantial amount of corporate restructuring and is having a more pronounced effect on middle-class, white-collar jobs. We have heard much more talk of economic hardship this time around because more of the people hurt by this recession are well-educated and articulate and therefore are conspicuous to politicians and journalists. It has been a very long recession and it is not going to be followed by a dramatic resumption of growth the way previous ones were—the recovery, when it comes, will be seriously constrained by large federal budget deficits and heavy government borrowing, by the reduction in foreign financing from Japan and Germany, and by the effects of new regulatory programs that have greatly increased the costs and uncertainties of new investment and new hiring.

"Conservatives and libertarians play a risky game in making the recession a centerpiece of their attacks on President Bush."

Even very healthy economies do not grow without pause or without dislocations caused by shifts in private patterns of production and consumer demand—as Herb

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED



Archive Photos

"The central task of economic policy is to revive the growth in productivity that has slowed down since the early 1970s."

Stein said in a recent article, "Recessions Happen." I doubt that the Bush administration could have done anything to prevent a recession following the long expansion of the 1980s, or to avert the recent corporate restructurings, many of which were long overdue and will be beneficial in the longer run. Conservatives and libertarians are playing a risky game in making the recession a centerpiece of their attacks on President Bush's policies.

People of all political persuasions whose lives are absorbed in politics and public affairs tend to exaggerate the consequences of government policies in order to magnify the stakes of the political battles they are engaged in. In fact, an economy as immense and diversified as ours is capable of absorbing a tremendous amount of government-imposed damage and continuing to perform quite nicely. This is an important but little-appreciated implication of Ronald Coase's work, which won him the Nobel Prize last year, and of the "rational expectations" school of macroeconomics that builds on Coase's work.

Although the tendency to exaggerate the influence of government policies is an occupational hazard of both liberal and conservative activists, it's a much more serious problem for conservative and especially for libertarian activists. The great proficiency and self-governing power of private markets is *our* argument, after all. If we adopt the premise that the economy is a hothouse flower, acutely sensitive to every policy adjustment made in Washington, what has happened to our argument that government programs are often futile because private interests and markets compensate and compromise their purposes? If we wish to encourage greater modesty in the claims of government, we need to be more modest in the claims we make for our own policies.

Having said all this, I do think the domestic policies of the Bush administration have been harmful and have contributed to our present economic difficulties. The serious problems of our banks and thrifts, for example, are largely the result of government policies and were clearly evident at the time George Bush took office. Although the economy-wide costs of these problems have been cushioned by the growth of other, unregulated financial institutions, the costs and dislocations could have been greatly ameliorated by some fairly straightforward reforms—especially abolition of the Glass–Steagall Act and privatization of deposit insurance—that the administration repeatedly shied away from. The new Clean Air, Civil Rights, and Americans with Disabilities Acts are going to impose many billions of dollars in annual costs on the economy without remotely commensurate social benefits. The president's embarrassing embrace of managed trade during his recent trip to Japan seriously compromised American leadership on trade liberalization. The cumulative effect of these sins of omission and commission are significant, even in a $6-trillion economy.

President Bush's reneging on his "no new taxes" campaign pledge was the bellwether event of his presidency, comparable to President Reagan's handling of the PATCO air controllers' strike in 1981. Both actions had consequences far beyond the issues at hand, because they were convincing signals to political allies and foes, bureaucrats, and private citizens of how the president would respond to political pressures in a multitude of other circumstances. Reagan's breaking of the PATCO strike signaled, accurately, that "no more business as usual in Washington" was more than campaign rhetoric. Bush's agreement to a tax increase he had vowed never to accept signaled, with equal accuracy, that it was back to business as usual. Everyone in Washington, with the possible exception of a few of President Bush's advisers, understood that the 1990 budget agreement was not about solving a particularly knotty fiscal problem, but about whether it was safe to get back to promoting increased federal spending, taxation, and regulation. In both cases millions of private citizens understood what was happening and adjusted their affairs accordingly, adding to productive economic activity in the 1980s and subtracting from it in the 1990s.

***P.R.:* Would you favor a "growth package" designed to boost the economy this year?**

DeMuth: It depends on what you mean by "growth package." If you mean a pastiche of short-term tax and regulatory adjustments intended to inject immediate adrenaline into the economy this year, my answer is no. At best these sorts of gimmicks will be too small to have much effect on the general economy and will be instantly discounted; at worst—and more likely—they will signal a return to the politics of handing out tax exemptions and regulatory exceptions to politically influential groups, and to this extent will make the immediate economic situation worse.

If you mean policies aimed at reviving the long-term growth of productivity, income, and wealth—not before November but over the next several decades—then I'm in favor of them and claim they would have some positive immediate effects. This would include "credible steps"—meaning concrete actions as well as legislative proposals—toward curing the long-term insolvency of our middle-class entitlement programs, reducing govern-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ment-induced inflation in medical care costs, restoring freedom of contract in labor markets, reforming primary and secondary public education, eliminating regulatory barriers to innovation in high-growth-potential markets, and establishing less wasteful and more effective environmental programs. Every one of these steps would be dismissed out of hand as suicidal by today's practicing politicians and their managers and pollsters, but I am certain they could be politically as well as economically successful, even in the fairly short run.

***P.R.:* As you've noted, the budget deficit has disappeared from the public discourse of establishment Washington, even as the deficit itself has risen to its highest relative level since World War II. Under what circumstances, if any, are budget deficits a problem?**

DeMuth: The size of the annual budget deficit is not as important as the uses to which government spending is directed. Well-run businesses borrow constantly during periods of rapid growth, and they can do so indefinitely as long as they invest the money in activities whose economic returns exceed the costs of borrowing. Borrowing, whether by a business or a government, becomes a problem when it does not finance future growth. So the deficit problem is really a spending problem, because most government spending doesn't meet the growth test. This is not to insist that government spending should always meet a growth test, but only that expenditures on current consumption, such as income transfers, should be covered by current taxation or even (although this raises problems of its own) by surpluses.

To the extent the large budget deficits of the 1980s financed the substantial growth in our military capabilities, and to the extent this growth contributed to the collapse of the Soviet Union's international ambitions (as several well-placed Soviet officials have said it did), then this turned out to be a spectacularly productive investment rather than a squandering of our national wealth. On the other hand, budget deficits really are impoverishing if they simply finance current consumption or if they are wasteful—paying for things citizens don't want or encouraging inefficiency in private markets.

In all events, year-to-year budget deficits are not nearly as important as whether the total amount of national debt is rising or falling as a proportion of GNP. If total debt is rising rapidly in proportion to economic activity, as it is today, then current borrowing is unlikely to be financing future growth but is instead placing a growing burden on future generations.

***P.R.:* With the possible exception of the University of Chicago, AEI did more than any other research organization to lay the intellectual groundwork for the deregulation movement of the Ford, Carter, and Reagan administrations. What were the most important lessons from this triumph of ideas over entrenched political interests?**

DeMuth: The first lesson is that pure triumphs of ideas over entrenched political interests are rare to nonexistent. When ideas triumph, it is usually because they become harnessed to the interests of important political constituencies. This is not to denigrate the power of ideas. But those of us in the idea business need to appreciate that our role is not to slay dragons but to educate people to a more accurate and larger conception of where their interests lie.

The closest approximation to a pure triumph of ideas in regulatory policy was the revolution in antitrust incited by the work of Robert Bork, Richard Posner, and others in the middle 1970s. But this is the exception that proves my rule, because here there were no entrenched political interests. A collection of populist antitrust doctrines had grown up over the years through Supreme Court decisions, and although these doctrines produced a lot of economic damage they did not benefit any well-defined political constituency. For example, no particular group benefits in advance from a highly restrictive or highly permissive policy toward corporate mergers.

"The long-term prospects of Medicare and Social Security are much larger fiscal issues than the budget deficits that receive so much more attention."

As a result, the reversal of Warren-era antitrust doctrine in the 1970s and 1980s proceeded largely through intellectual debate in the law schools, law reviews, and eventually the courts, unimpeded by organized political opposition. The one exception, where Chicago School antitrust has yet to prevail, is in the area of permitting manufacturers to set the retail prices of their products in order to promote effective distribution and marketing; this is the one area where an influential political group—discount retailers—opposes the change.

In other areas of regulatory policy, for example airline regulation, research at AEI and elsewhere was certainly influential, but I doubt it would have prevailed in the absence of several important political and demographic developments, especially the decline in the political influence of unionized labor and the growth of the size and prosperity of the middle class. Senator Kennedy's airline deregulation hearings in 1978 played to an audience of potential airline travelers that had become larger and more politically important than unionized airline employees. The dramatic wage adjustments that followed airline and trucking deregulation showed that a large part of the excess profits produced by regulated fares and entry had been captured by unionized employees.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

It has been harder to deregulate broadcasting and telecommunications and financial markets because the interests that profit from government restrictions—cable television firms and stockbrokers, for example—have more political clout than the airline and teamsters' unions did. There is good reason to hope for progress in these areas, however. The pace of technological innovation has become so rapid that new markets are established quickly, before regulators have time to suppress them. And the economic costs of maintaining the existing regulatory programs are becoming so large and conspicuous that the foreseeable benefits of deregulation are generating political pressure for reform.

The economic benefits of deregulation have been enormous—if anything, even larger than economists predicted. The distribution of benefits has sometimes been surprising, but this is because free markets are driven by consumers rather than by government planners and often go off in unanticipated directions. For instance, the biggest winners from airline deregulation have been vacationers and those who used to travel by bus or car because they could not afford air travel. Business travelers—those who tend to complain about the effects of deregulation—have generally enjoyed significant gains as well, in price, frequency, and directness of route, but their gains have been smaller than others' and have often been compromised by more crowded coach cabins.

"The conservative movement's greatest strength is that it is the *avant garde* of American political thought."

The "excesses" of deregulation one hears about in the popular media are misunderstandings. The savings and loan debacle was a predictable (indeed predicted) result of too little deregulation—investment and interest-rate restrictions were removed while deposit insurance and other policies continued to guarantee depositors against risk, resulting in large government subsidy of imprudent pricing and investing. The judicial restructuring of AT&T was not deregulation at all, but rather a transfer of business decisions from within the old Bell System to the regulatory arena and the erection of a complex program of market allocation—the hallmark of protectionist regulation—administered by the courts.

***P.R.*: What are your major concerns about the Bush administration's approach to regulation?**

DeMuth: The president has made a few excellent appointments to the regulatory agencies, such as Alfred Sikes at the Federal Communications Commission, Wendy Gramm at the Commodities Futures Trading Commission, and Anne Brunsdale at the International Trade Commission. But mostly he has appointed men and women dedicated to aggressive expansion of their agencies' regulatory turf—then given them hefty budget increases. And he has passed up opportunities to reappoint principled deregulators, such as Heather Gradison, who had been the best chairman in the history of the Interstate Commerce Commission.

As a result, the front lines of federal regulation are currently manned by people dedicated to expanding those lines rather than improving the performance of the industries they regulate. The Securities and Exchange Commission, which is supposed to promote the efficiency of securities markets through financial information disclosure, has been thrashing about looking for new fields to conquer—futures markets, the Treasury bond market, corporate governance. The Food and Drug Administration has inexplicably embarked on a crusade to suppress the dissemination of truthful information about foods and pharmaceuticals, based on the pernicious idea that consumers and physicians cannot assess information that is partial or that comes from an interested source. It is very discouraging to see political officials so preoccupied with the narrow bureaucratic interests of their agencies when critical industries such as financial services and pharmaceuticals are badly overregulated to begin with.

I am also concerned about the lack of leadership from the top. Although the vice president's Council on Competitiveness has done heroic work in trying to counter the growth of regulation, it lacks the staff and institutional authority to deal with the scores of regulatory proposals that come out of the agencies each week. The Office of Management and Budget's regulatory branch has a large and knowledgeable staff and an able career director, but its lack of political leadership for three years running has seriously weakened the regulatory review program established in earlier administrations.

***P.R.*: You were head of OMB's Office of Information and Regulatory Affairs (OIRA) in the first Reagan term. What did you do that is not being done now?**

DeMuth: The Reagan administration established a fairly effective program at OMB that reviewed all executive-branch regulations under a cost-benefit standard. I administered the program for several years, but the effort was led by then-Vice President Bush and involved several others—Dave Stockman, Jim Miller, Doug Ginsburg, and Wendy Gramm. And although President Reagan's strong views on federal regulation gave the program particular bite, it was not a dramatic new departure but rather an extension of similar programs of the Nixon, Ford, and Carter administrations. Central review of agency regulations is a natural and nonpartisan response to the growth of regulation itself, much as central review of agency budgets was a response to the growth of federal spending in the 1910s and '20s.

During the Reagan years the review process was solidified and extended to include a twice-yearly exercise in which the agencies and OMB would agree on rulemaking priorities, including both new regulations and aboli-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

tion or reform of existing regulations, for the coming months. More important, the cost-benefit standard—the principle that new regulations should be issued only on good evidence that the social benefits would exceed the social costs—was established as executive branch policy and, through rulemaking and litigation, made some headway in the courts. Eventually an executive order applied the cost-benefit standard in the form of detailed program-by-program guidelines.

Our greatest failure was not getting the cost-benefit standard and OMB review process codified in statute and applied to rulemaking by the so-called independent regulatory agencies such as the Federal Trade Commission and the Securities and Exchange Commission. A bill to do this passed the Senate 94-0 early in President Reagan's first term, but died in the House. President Bush should propose such legislation and fight for it now. This would be a better way of getting the agencies to focus on regulatory reform than the "regulatory moratorium" and other administrative steps the president has taken recently. It would precipitate a huge controversy in the Congress, but the controversy would concern the right questions—which economic standards should guide regulatory decisions, whether regulatory agencies should be accountable to the president or to the congressional committees—rather than sideshows like industry meetings with White House officials.

***P.R.:* Rumor has it that you were one of the top candidates for Environmental Protection Agency administrator in the first Reagan term. What direction do you think environmental policy should be going in?**

DeMuth: The American people strongly support large public expenditures on improving the environment. This is an important and appropriate function of government in the modern world, and one that political conservatives should embrace with enthusiasm.

The policies we are pursuing to protect the environment are, however, enormously wasteful—we could be achieving the same degree of environmental quality for much less cost or far more quality for the same cost. The standards set by the EPA for pollutants force expenditures to reduce public health risks that are far in excess of what anyone spends to reduce private risks, and many of them force large expenditures that produce no health benefits at all. And the means employed to achieve environmental goals are often extraordinarily wasteful in themselves, due to EPA's reliance (often required by statute) on command-and-control techniques and engineering controls that set a uniform standard for all firms regardless of cost-effectiveness.

Environmental problems are ultimately issues of scarce resources, and the most equitable and efficient approach to allocating scarce resources is through markets and private property. The current regulatory programs should be considered way-stations toward establishing enforceable private property rights in environmental resources. The first steps in doing this are setting pollution-control standards that are within the bounds of health and amenity expenditures people make in their private lives, and then achieving those standards through markets rather than mandates. The EPA has taken some tentative steps in this direction, and the new Clean Air Act gives it additional flexibility in a few areas; but we still have light years to go.

***P.R.:* How would you characterize the discipline of economics today?**

DeMuth: Academic economics has become excessively concerned with questions of theory, especially game theory, and insufficiently concerned with testing theory against practical experience and the actual behavior of

"Bush's agreement to a tax increase he had vowed never to accept signaled that it was back to business as usual in Washington."

firms, markets, and other economic institutions. Game theory is very appealing to young academics eager to make their mark in the journals—it offers opportunities for the display of mathematical virtuosity and it enables one to demonstrate or refute just about anything. Depending on the assumptions of a game, one can "prove" that higher or lower taxes, more or less regulation, or greater or fewer trade restrictions are good for the economy. Game theory is fun but it cuts the student loose from the parsimony of economics: rather than making strong and refutable predictions based on a few behavioral assumptions, it makes malleable predictions based on an abundance of assumptions. Because it is self-contained—beginning and ending on a blackboard, so to speak—it elides the painstaking, time-consuming business of explaining the behavior of real institutions and venturing policy proposals that address real rather than assumed behavior.

Academic economics has also become deeply interested in "positive" rather than "normative" questions—in explaining why government policies are as they are, rather than what they should be. This is a healthy and promising departure, but I worry that it makes many good economists appear agnostic or uncaring about the substance of policy. One of AEI's chief tasks is to attract bright economists to the task of explaining how policy could be improved, rather than why it is so bad.

***P.R.:* Was Michael Milken an American hero?**

DeMuth: I would not call him a hero—I would call him an accountant turned financier who turned out to be astoundingly gifted at both. The genius of our economic system is supposed to be that it produces miracles of material welfare out of unheroic individual actions, and

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Archive Photos

"The biggest winners from airline deregulation have been vacationers and those who used to travel by bus or car because they couldn't afford airfares."

Milken personified this genius. He saw major gaps that no one else saw in the way our financial markets were organized, and he acted with immense talent and energy to fill them. In doing so, he and many other young financial revolutionaries of the 1980s were responsible for an enormous amount of social good.

The financial markets of the 1980s were scenes of a certain amount of fraud and abuse, but I have seen no evidence suggesting that there was more fraud than has existed in financial markets in other times. It was a period of great economic dynamism, when new firms and new financial techniques were rapidly dislodging established ones. Those who were being lashed by the gales of competition turned to the media, to the political process, and to criminal prosecution to get revenge on purely economic adversaries. Milken, who had been the leading revolutionary, ended up being the leading victim. The government never even tried to demonstrate that he was guilty of the scores of serious crimes it charged him with, and I think it could not have done so. The six charges he pleaded guilty to were mostly minor technical violations—indeed charges that he accommodated customers' violations—that had never drawn a major sentence before Milken. I think the Justice Department was guilty of a shameful abuse of individual rights in the case—it should have disavowed any reliance on the RICO statute, refused to accept a plea bargain, and tried its case through to conclusion. Among other things, this would have produced a formal record and decision regarding just what it was, if anything, that Milken did wrong—something that to this day no one can say with any specificity.

***P.R.:* AEI is probably closer to top corporate leaders than is any other public policy research organization. How would you assess the political agenda of American business today compared with 10 or 20 years ago? Have the big corporations learned to love big government?**

DeMuth: There is about as much diversity in political views among corporate executives as among others of the same age and education. But even liberal businessmen are "conservatives" when it comes to managing their own companies, and even conservatives can be persuaded of the virtues of government spending, regulation, and tax-preferences when these things give their firms advantages in the marketplace.

I think the latter tendency is no stronger today than it was 20 or even 100 years ago; after all, most of our oldest subsidy and regulatory programs were established and maintained with significant business support. What has changed in recent decades is that the political consensus supporting limits on the scope of government has evaporated—not only has government grown in size and

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

complexity, but the possibilities of government intervention have become much greater than they used to be. As a result it has become more difficult for business executives to be active free-marketers and anti-interventionists, whatever their personal opinions. The possibilities for government to help their firms—or to hurt their firms at the behest of others—are everywhere, and ignoring these possibilities jeopardizes the economic interests of shareholders just as surely as ignoring market opportunities and threats. The daily reality is that business firms must work with, and to a degree cooperate with, the bureaucracies at the FDA, EPA, and scores of other agencies—agencies with enormous discretionary power over their businesses, long institutional memories, and a demonstrated willingness to get even with troublemakers.

The business dilemma is like the problem of congressional term limits: voters consistently favor term limits while reelecting their own entrenched congressman every election, because they realize incumbency has advantages and that voters in other districts will be returning *their* incumbents. Limited government is a "public good"; when the limits are dropped, self-interested individuals and firms will adjust their behavior accordingly.

Many corporations are far more timid and risk-averse than they should be, strictly from the standpoint of immediate corporate self-interest, in dealing with the bureaucracies, the congressional staffs, and the courts. But they are also the single most important positive force in American politics—and conservative and libertarian activists would do well to meet them more than half way and to try to work with them as effectively as liberal activists worked with labor unions in an earlier era. Most individuals of conservative or libertarian disposition do not go into politics, they go into business and finance, and they take their views with them as they climb the corporate ladder. Those who do well are among the most talented, imaginative, and energetic people in our society. Business life rewards and cultivates the virtues of hard work, self-discipline, and efficient management of resources; it commands attention to detail, measurement, the logic of cause and effect, and the workings of supply and demand. People who come out of this culture, even those of generally liberal political bent, usually bring a conservative slant as well as much useful knowledge to the policy issues they are concerned with.

In some respects, the business community is becoming more market-oriented than ever. It enthusiastically endorsed President Nixon's wage-and-price controls in 1971, but would not do so today or in the foreseeable future. The younger generation of business executives and entrepreneurs seems to me quite adamantly libertarian on economic policy. Institutions like AEI and dozens of others around the country would not exist without corporate financial support, in large part because business executives realize that independence as well as specialization permits us to be more effective advocates of private enterprise. AEI has occasionally lost a corporate donor because of our positions on import restraints or commercial subsidies, but these incidents have been rare.

***P.R.:* What are the most important institutional and intellectual strengths and weaknesses of American conservatism?**

DeMuth: The conservative movement's greatest strength is that it is the *avant garde* of American political thought, as it has been now for the past 20 years. We are not a majority, or even a majority within the Republican Party, and, although we have won some notable victories, most of the time we do not get our way when it comes to concrete political decisions. But most of the great issues in American politics today are argued within the conservative movement—in our think tanks, journals, caucuses, and conferences—and these conversations determine how the issues are advanced and debated before wider political audiences.

Conservatism is a large enough tent to hold subgroups representing most of the important tendencies in contemporary politics—social conservatives, neoconservatives, libertarians, Buchananites, the law and economics movement. Its major ideas have been ratified by objective developments clear to most ordinary citizens—the collapse of Communism, the failure of many liberal domestic programs, the growth of crime and welfare dependency, the exhaustion of state and federal budgets. And political liberals, who held the

"Many corporations are too timid in dealing with bureaucracies, congressional staffs, and courts."

political *avant garde* in the 1950s and 1960s, have so far failed to come up with an alternative set of ideas that are intellectually convincing or that fit contemporary experience. The *New Republic* is now thoroughly neoconservative on everything but economic policy and income redistribution, and these are the weakest parts of the magazine. The *American Prospect* has run some interesting articles but so far it is not close to advancing a liberal "new paradigm."

The conservative movement's greatest weakness is that, with the retirement of Ronald Reagan, it has lost its leader—someone who could get the various conservative factions to suppress their differences, and who could mainstream their major ideas into the wider political debates. For the time being, the conservative movement is torn by factional and institutional rivalries, which are healthy up to a point but which threaten to weaken the movement as a whole. With no new Ronald Reagan on the horizon and the Republican Party once again controlled by pragmatists, the conservative challenge is to learn to hold our issue-defining position without the assistance of a single galvanizing leader.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Bush's Fatal Attraction

Anatomy of the Budget Fiasco

Terry Eastland

It is now widely recognized that the budget agreement of 1990 has been the greatest mistake of the Bush presidency. The agreement has failed by its own criteria to reduce either federal spending or the budget deficit, both of which now stand at postwar highs as a percentage of gross national product. By raising taxes without truly solving any long-term structural problems in government spending, the agreement has penalized the private sector in the short run and reduced Americans' long-run confidence in the health of the economy. The agreement has thus contributed to both the depth and the length of the recession.

The political mistakes of the budget agreement were as serious as the economic mistakes, and they account, as much as any other factor, for the strong showing by Pat Buchanan in the early primaries and the widespread disillusionment with the president within the typically very loyal Republican Party. Not only did President Bush break a promise to the American people that they took seriously, he also broke the most important clause in his contract with the conservative movement that has supplied most of the driving force for Republicans over the past 14 years. The political damage to the administration that results from the feeling he cannot be trusted will haunt President Bush even if he wins reelection. The breach cannot be repaired until he goes beyond his early March regret and undoes the budget agreement that caused the damage.

Misunderstanding the Presidency

In addition to these political and economic failures, the budget agreement represents a fundamental misunderstanding of the office of the presidency. The Framers of the Constitution understood the presidency as the unique source of energy in government. "Energy in the executive," Alexander Hamilton wrote, is a leading characteristic of good government—which by definition must be limited government. Energy in the executive takes many forms. In his dealings with Congress, the energetic executive uses his office to frame rational terms of political debate.

President Bush conspicuously did not do this in 1990 when he sought a "deficit-reduction" package from Congress. Committing himself to what Washington is pleased to call "process," Bush failed to clarify the political and economic choices available to the nation as he could have done by stating what those choices were, which ones he endorsed, and why. In sharp contrast to the president who pushed Saddam Hussein from Kuwait in 1991, Bush in his budget policies did not cut a profile of energy in the executive.

The problems, in retrospect, began with the campaign in 1988. Having repeatedly stated his opposition to tax increases, Bush used his 1988 acceptance speech at the Republican National Convention to say, famously, "The Congress will push me to raise taxes, and I'll say no, and they'll push, and I'll say no, and they'll push again, and I'll say to them, 'Read my lips: No new taxes.'" Bush's promise helped him get elected, but he made no larger effort to frame a principled debate over the direction of the nation's fiscal policy.

Nor did Bush, once elected, try to enlarge the discussion of fiscal policy, as he continued simply, and simplistically, to reiterate his campaign vow. Bush could have broadened and defined the public debate through speeches to Congress and the nation that would have advocated an economic growth policy focused on tax and spending policy. After all, if no-new-taxes was to stick, Congress eventually would have to make some hard spending choices, and the presidency was the office of government best positioned by the Constitution to make this point and to frame the terms of debate as to how, where, and why the budget should be cut. The president is more able than a plural body, which is what Congress is, to develop and prosecute a public case for spending reductions. The president, as Thomas Jefferson said, is the only constitutional officer who can see "the whole ground." Only from him can Americans expect what Hamilton described as "arduous, extensive" enterprises undertaken for the public good.

Having failed to employ his office in an "arduous,

Terry Eastland *is a resident fellow at the Ethics and Public Policy Center in Washington, D.C. His article is adapted from his forthcoming book,* Energy in the Executive: The Case for the Strong Presidency *(Free Press).*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

extensive" enterprise, Bush found himself in the spring of 1990 faced with the prospect of a larger deficit for fiscal year 1991 than his budget office had only months earlier predicted. The focus of President Bush's fiscal policy suddenly switched from no-new-taxes to deficit reduction, which implied the possibility of new taxes. Yet Bush did not try to frame the debate over deficit reduction, either. At a press conference on May 3, 1990, the president merely said that he intended to "talk process" with congressional leaders from both parties, and that he would ask them to join him in a "budget summit" on which he would impose "no preconditions."

Disdain for Public Debate

Bush thus committed his presidency to a method of seeking legislation that disdains public debate over important policy ends, relying instead on private meetings aimed at producing a Washington consensus. One problem with this method of governing is that, in the absence of a clearly defined public position, presidencies tend to resort to strategies of finesse that seldom lead to satisfying results, whether for the president, the political "process," or the nation. So it happened in this instance.

Not surprisingly, Bush's "no preconditions" remark was interpreted in the press and by Republican congressmen as a willingness on his part to accept some (as yet unspecified) tax increases. In a clumsy effort at "spin control," Chief of Staff John Sununu told reporters—on "background" as a senior administration official—that "no preconditions" meant Democrats could propose tax increases but the White House would veto them. Fearing a trap in which their party would be cast by the president as the one proposing new taxes, Democratic congressional leaders refused to reach any kind of budget agreement until the president signaled a different position. Constrained by his unwillingness to use his office to frame a public debate and his commitment to "process," and with his budget office now forecasting a fiscal year 1991 deficit of close to $170 billion, Bush attempted to finesse Democrats back into the huddle. Meeting with the congressional leadership on June 26 for a White House breakfast, Bush issued a statement through his press secretary:

> I met this morning with the bipartisan leadership—the Speaker, the Senate majority leader, the Senate Republican leader, the House majority leader, and the House Republican leader—to review the status of the deficit-reduction negotiations.
>
> It is clear to me that both the size of the deficit problem and the need for a package that can be enacted require all of the following: entitlement and mandatory program reform, *tax revenue increases*, growth incentives, discretionary spending reductions, orderly reductions in defense expenditures, and budget process reform, to assure that any bipartisan agreement is enforceable and that the deficit problem is brought under responsible control. The bipartisan leadership agree with me on these points.
>
> The budget negotiations will resume promptly with a view toward reaching substantive agreement as quickly as possible. [Emphasis added.]

That was it. "Tax revenue increases" can refer to revenues from ordinary economic growth or tax rate cuts (such as Bush had proposed on capital gains). But it can also mean higher tax levies. There was no White House explanation of the meaning of the ambiguous phrase by the president or his aides. Asked about it in the White House Rose Garden, Bush only said, "I'll let the statement speak for itself." Others—in the media and on Capitol Hill—filled the interpretive void. "Bush Abandons Campaign Pledge, Calls for New Taxes," ran the headline in the *Washington Post*. "Read His Lips: New Taxes After All," said the *Washington Times*. Lesley Stahl of CBS went further: Bush, she said, was "reversing 10 years of Republican catechism on taxes."

"This Deficit Is Bad"

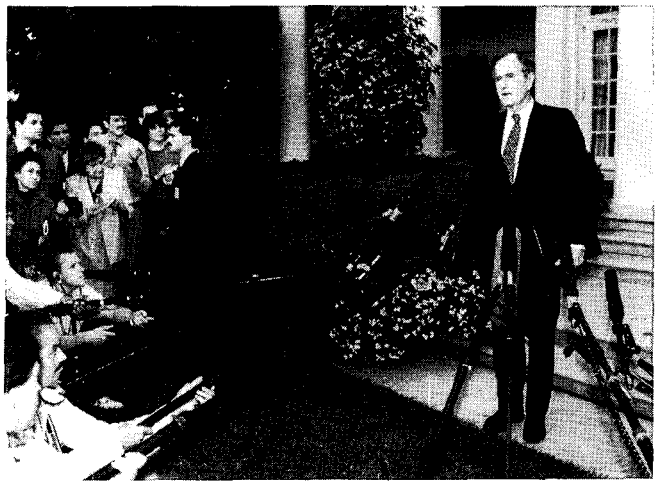
Here was the single most important issue of domestic policy—the overall level of federal taxing and spending—and Bush was trying to hide from his position rather than frame the debate. The president tried to dance his way out of difficulty through his favorite means of public communication, the press conference. But the president failed to explain why he had taken the position on taxes suggested in the statement. He simply asserted that "this deficit is bad," making no argument for that proposition. And he said that the people "know" the deficit is bad. Yet the people did not know that. The people could have drawn other conclusions from the available economic data; it was not obvious, for example, just why the budget deficit had to be reduced through higher taxes or lower spending at a time when the economy was stagnating.

Here was the single most important issue of domestic policy, and Bush was trying to hide from his position.

The president said that he was motivated to accept tax increases by the threat of "draconian cuts in defense, student grants, and a wide array of other necessary domestic services"—cuts that would result (through the process known as "sequestration") if Congress failed to meet the budget targets in the Gramm-Rudman-Hollings budget act. Bush seemed horrified by the prospect of any such cuts, but he did not use the press conference to make the case for entitlement reform, discretionary spending reductions, or budget process reform—three of the items characterized in his statement three days earlier as "required" in any agreement. His focus was taxes.

Bush's press conference amounted to a statement that the American people should simply believe him as to the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED



Reuters/Bettmann

The press conferences Bush is so enamored of are a poor means of presenting a legislative policy and framing a coherent argument in its behalf.

desirability of reducing the deficit through some as yet unspecified taxes, this after he had abandoned his long-held promise to oppose any new taxes. The press conference did little to allay his credibility problem, much less to advance the cause of deliberative government.

Speechless White House

This is hardly surprising, because press conferences are a poor means of presenting a legislative policy and framing a coherent argument in its behalf. The president must share time with reporters who ask questions that can bounce from one subject to another or who wish to "pin" him down on a matter he would not care, or is not prepared, to talk about. Also, in press conferences the president typically does not read from a prepared text that can reflect his well-considered (in the best of all worlds) views. Press conferences (and television talk shows, for that matter) are most useful in reiterating points or arguments previously made—preferably in prepared speeches, which are a superior means of engaging the public debate.

It is a measure of the frequent weakness of Bush's presidency that he prefers press conferences to speeches. During his first year in office, he gave almost six times as many press conferences as Reagan annually averaged, and he made only two nationally televised speeches to the nation during evening hours, and one of these (on Thanksgiving eve) was largely ceremonial. A president who so prefers press conferences that he neglects the public argument he can make through well-considered speeches is underemploying the presidential office.

Triumph of "Process"

With his June 30 press conference, Bush did manage to get the "process" moving again. Throughout the summer the administration maintained that the capital gains rate should be cut, while Democrats, emboldened by Bush's willingness to accept new taxes, began to press, in the name of "fairness," for higher marginal rates for taxpayers. Eventually the Democratic leadership agreed to a capital gains reduction if the Republicans would accept an increase in the highest marginal rate for individual taxpayers, to 32 percent from 28 percent. When the White House refused the offer, the budget summiteers, with Bush's blessing, decided on a package that included neither capital gains reduction nor a higher marginal rate for top income earners. Instead, taxes on gasoline, cigarettes, wine, beer, and hard liquor were to be increased, and a new luxury tax on certain expensive items was to be levied. There was to be an effective tax increase for those making more than $100,000 (as a result of a new way of itemizing deductions), and an increase in Medicare taxes for those making more than $51,300. In all, taxes were to rise by roughly $134 billion over the five-year period. Meanwhile, defense spending was to be chopped by $170 billion. The $105 billion in projected savings for non-military spending—mostly Medicare, student loans, farm subsidies, and certain federal employee benefits—were concentrated in fiscal years 1994 and 1995, and therefore are subject to later repeal.

Throughout this period Bush sealed his lips; he did not address the nation on the shape of fiscal policy. On September 30 Bush went to the White House Rose Garden with congressional leaders of both parties at his elbows to announce the budget agreement they had struck. If the "process" had worked to the president's satisfaction, it quickly proved not to have worked politically. Immediately it drew opposition in Congress from both liberal Democrats and conservative Republicans. Liberals thought the package hit the middle class and the elderly too hard while barely touching the wealthy, and conservatives were appalled at the prospect of one of the largest tax increase packages in history.

Last-Minute Appeal

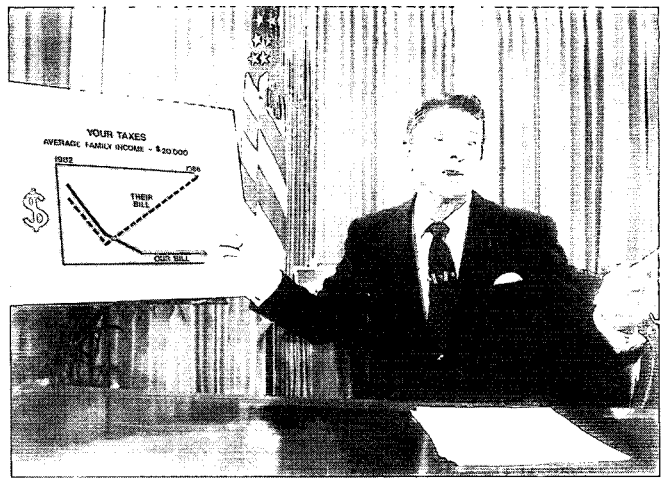
In response to these developments, on October 2 the president decided to appeal to the nation for help. But Bush's first popular speech on the central domestic issue of his first two years in office was no part of any strategic effort to frame the public debate. Like his press release of June 26 and subsequent press conferences, this, too, was reactive in character.

The president told the nation that the budget deficit was a cancer gnawing at our nation's health. Unless contained and cut back, the economy would be further weakened and thousands of jobs lost. Bush said "we can do something"—enact the budget agreement, which he presented as the product of a bipartisan process. The agreement wasn't perfect, he said, just "the best...that can be legislated now." He acknowledged that it contained tax increases, which he was not "a fan" of, but nonetheless these increases "should allow the economy to grow" by reducing the deficit and therefore lowering interest rates. Bush emphasized that the agreement would not raise income tax rates, personal or corporate. Ominously, he added that failure to enact the agreement would result in a faltering economy and even recession. He noted that the Democratic majority leader, Senator George Mitchell, speaking after him, would not assume the traditional role of opposition but one of support. Finally, the president talked directly to the viewer: "I ask you to understand how important and, for some, how difficult this vote is for your congressmen and senators.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Many worry about your reaction to one part or another. But I want you to know the importance of the whole. And so I ask you to take this initiative: Tell your congressmen and senators you support this deficit-reduction agreement....Your senators and congressmen need to know that you want this deficit brought down."

The people did the opposite; a huge majority of the citizens calling Capitol Hill said no to the budget accord. It would have been surprising had the reaction been otherwise. The history of presidential rhetoric from Theodore Roosevelt through Ronald Reagan shows that last-minute popular appeals rarely rally public opinion behind a president's legislative goals. Bush's very language at the end of his October 2 speech—"This is the first time in my presidency that I have made an appeal like this to you, the American people"—revealed the desperation of a president who had not used rhetoric as he properly could have, beginning much earlier in his presidency, in order to meet his constitutional duty to recommend legislation. Had Bush employed popular speech earlier and properly, making a consistent, well-considered case for his fiscal policy, Congress might well have produced a package more reflective of the president's political goals and more appealing to more legislators.



UPI/Bettmann

Unlike Ronald Reagan, here selling his tax cuts, George Bush has failed to make the case before the American people for his economic policies.

Blurring of Differences

Bush's rhetorical failure was related to his preference for the kind of process he entered in order to reach a budget agreement. Both seemed to result from an aversion to the kind of politics our system demands, especially in an age of divided government. By joining forces with congressional leaders in a "budget summit" whose results were to be presented to Congress and the nation virtually as a *fait accompli*, the president, together with the bipartisan congressional leadership, effectively sought to blur party and institutional differences, thus deemphasizing principles and ideas. With such summits, there is no need for the president to advance a public case, or for the opposition party (here the Democrats) to actually be in opposition, or for the two houses of Congress to deliberate in accord with procedures established in the Constitution. For that matter, with inter-branch, bipartisan, closed-door summits, there is no need to assign responsibility and hold anyone accountable.

The swift rejection by the House of the budget accord demonstrated the futility of trying to govern in the absence of politics. "What this vote proved was that closed-door sessions don't work," said Representative Bill Thomas, a California Republican, who added that "the whole process should begin and end with full public debate." Vice President Dan Quayle's advice in mid-October that the president should take his case for economic policy to the voters reflected a similar belief that politics and governing should be related. Both Thomas and Quayle were right.

The nation needs more politics, not less, if it is to reach consensus during a time of deep division about economic policy. As the *Wall Street Journal* put it on October 4, 1990, "What the United States dearly needs right now is a large national debate over its priorities....[T]here are deep philosophical differences between the political ideologies in this country. The purpose of a functioning democratic system is to clarify and resolve those differences, ultimately with elections in which the voters choose between two positions."

"Read My Hips"

The vote in the House rejecting the budget agreement was 254 to 179, with Republicans voting 105 to 71 against. With Bush now unable to count on House Republicans as allies, liberal Democrats in Congress began pressing for a new package that would increase the top personal tax rate without any cut in the capital gains rate; they also stepped up the attack on Bush's proposal to cut capital gains, characterizing it as welfare for the wealthy.

Bush himself took a series of contradictory positions on whether he would accept a higher marginal rate for "the rich." On October 9, at a press conference, Bush said that he would, if it could "be worked out in the proper balance between the capital gains rate and the income tax changes." Later that same day, after a meeting with Senate Republicans, Senator Bob Packwood of Oregon said, "The president agreed, our unified position is we will not go up on the rate, not 1 percent, not 2 percent, not one penny....And we will leave the rates where they are, drop capital gains and do nothing about the rates." The following morning Senator Robert Dole remarked on the floor of the Senate, "[President Bush] did not make any decision yesterday, even though that was reported. He listened to us. He did not announce his position at all. He did not acquiesce in what we said." Meanwhile, the president, asked to clear up the confusion, said while on a campaign swing in North Carolina and Florida that Congress should do that. Later in the day, while jogging in Florida, Bush was asked whether he was ready to give up cutting capital gains. "Read my hips," he said, mocking himself. The next day House Republicans met with President Bush. One of them, Representative Bill Archer, said, "He [Bush] is willing—and I think he'll speak to you today about this—to equalize or level the rate at 31 percent...in exchange for a 15 percent capital gains rate....I'm telling you that he

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

told us today that he has been consistently for this all the way through." Later that same day White House Press Secretary Marlin Fitzwater quoted the president as saying: "I do not believe such a compromise is now possible. Indeed, I'm quite concerned that pursuing it in the current context may not only fail; it may legitimize something farther to the left that we cannot accept." This is the kind of constant confusion that can be expected when a president is attracted to process-governing.

Bush staggered toward and finally got his package. The five-year deal called for cutting spending by $320 billion while hiking taxes by at least $170 billion. Specifically, it included an increase in the top personal tax rate from 28 to 32 percent, with certain very affluent taxpayers taxed an additional two percentage points. Also in the package were increases in Medicare taxes (for middle- to higher-income earners) and gasoline taxes. There were cuts amounting to $101 billion in benefit programs ranging from Medicare and Medicaid to farm subsidies and veterans benefits, again concentrated in fiscal years 1994 and 1995, and reductions totaling $67 billion in defense. The remaining amount of budget-reduction "savings"—some $115 billion—were to be determined by House and Senate appropriations committees, but not until the fourth and fifth years of the budget accord.

This year's deficit is $170 billion higher than projected at the time of the budget deal.

Disastrous Results

The events of 1990 showed that Bush wanted a deficit-reduction agreement above all else. Yet the White House only quietly put out word that the president supported the overall package that was ultimately enacted. And "a senior White House aide," as the story in the *New York Times* put it, "tried to regain the political offensive by calling reporters into the Roosevelt Room to issue a broadside against Democrats for having forced the president to raise taxes." When asked by reporters what he was going to do with the new package, the president replied, "I'm going to say, look, I've reluctantly signed this." Campaigning for congressional Republicans, Bush talked about how wonderful it was to be out campaigning among "real people" who had nothing to do with Washington, making little effort to explain and defend the budget agreement. Thus had campaigning ("no-new-taxes") been disjoined from governing (the budget accord), and then governing disjoined from campaigning.

This is a remarkable end to the story of the budget accord. Unlike President Reagan upon passage of the Tax Reform Act of 1986, Bush wanted as little as possible to do with what he helped bring about. Having distanced himself from his no-new-taxes vow, he now wanted to sprint away from his budget agreement. After the 1990 elections, in which the GOP lost nine House seats and which revealed strong sentiment in the electorate against new taxes, especially at the state level, Bush, ever the tactical politician, tried to put the budget package behind him by resurrecting an old theme: he was against new taxes. But the position was no longer credible.

The results of the budget summit have been disastrous for the president. The Congress is now more Democratic than any time since 1979. Once the euphoria over the Gulf victory subsided, the president's personal approval ratings have plummeted. The deficit for fiscal year 1991 was roughly $70 billion more than the administration forecast when the president signed the agreement into law in October 1990. The deficit for FY1992 is now projected to hit almost $400 billion, some $170 billion more than the administration projected at the time of the budget accord. And Democrats want both to raise taxes again and to lift the agreement's spending caps.

To make matters worse, despite the president's campaign-inspired admission that the budget deal was a mistake, there is no indication that he has learned from his error. Viewing campaigning as different from governing, he has suddenly begun employing rhetoric worthy of Ronald Reagan in an effort to woo conservatives. Yet the president did not use his State of the Union opportunity as the opening paragraph in a long, campaign-year argument about how we might generate real economic growth. Instead the speech was most remarkable for its disdain for ideas and argument and its imperial attitude toward Congress: The president employed the imperative mood on several occasions, as though Congress were Saddam Hussein. ("Congress, pass my bill.") But while the imperative is the mood appropriate for a commander-in-chief, it is not for a president seeking legislation from a co-equal branch of government. Nor is it appropriate in domestic policy for a president to ask Americans to rally around him because he knows what is best for the country. He has to make the case for his views. Different tasks require different kinds of presidential leadership.

Today as was true in 1990, the most important domestic policy issue facing the country remains: How much taxation and how much government do we as a people really want? And, relatedly, which government policies best contribute to economic growth? And today, as was true two years ago, the nation could use the leadership of a president who does not scorn politics in the best sense of that word but is willing to fully use the office he holds by framing rational terms of debate. ☎

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Real Taxpayer Protection

Sound Deposit Insurance Through Cross-Guarantees

Representative Thomas E. Petri and Bert Ely

Wednesday, March 8, 1933. The White House. Franklin Roosevelt, in office just four days, is holding his first news conference. The nation's banks have been closed for three days. America is in the throes of its worst banking crisis ever.

A reporter asks FDR about the wisdom of enacting federal deposit insurance. In response, he issues this prophetic warning: federal deposit insurance will guarantee bad banks as well as good banks, it will cost the taxpayers money, and it will put a premium on unsound banking in the future.

How right he was, as Americans have sadly learned over the past decade. Insolvent S&Ls will cost taxpayers $200 billion. Healthy banks and thrifts, which also are innocent victims of the S&L crisis, will be overcharged $5 billion to $6 billion this year for their deposit insurance. And regulatory overreaction to banking and S&L problems has caused sound but fearful bankers to restrict credit for many good borrowers.

In short, the time has come to heed Roosevelt's warnings, and replace federal deposit insurance with a new form of protection for depositors and taxpayers.

Flawed System

Federal deposit insurance has suffered enormous losses because it has relied exclusively on government regulation and supervision to contain losses rather than using risk-sensitive insurance premiums and other marketplace mechanisms to deter risky banking. For a long time, regulation held bank insolvency losses to an acceptable level. The political process, however, which is dominated by a preference for the status quo, has prevented regulation from adapting to rapidly changing conditions in the financial services marketplace.

Almost 90 percent of all deposit insurance losses have come from failed thrift institutions, that is, S&Ls and savings banks. Federal policy after 1933 transformed the nation's thrifts into very unsound financial institutions by encouraging them to engage in "maturity mismatching," using short-term deposits to fund long-term (20-year or more) home mortgages. Various postwar regulatory policies perpetuated and exacerbated this unsound financial structure, something a sound deposit insurance system eventually would have priced out of existence. The interest-rate explosion of the early 1980s drove interest costs on deposits above what almost all thrifts were collecting on their mortgages. Two hundred thrifts failed then, and hundreds more were left hopelessly insolvent.

Rather than confront and cure the thrift crisis of the early 1980s, and also reform deposit insurance, Congress ducked and gave thrifts broader lending and investing powers that many institutions were unequipped to use properly. Worse, lax regulation allowed hundreds of S&Ls to grow rapidly through reckless lending that fueled an overbuilding of commercial real estate in many regions. This oversupply triggered an asset deflation as real estate values plunged, which in turn caused many real estate loans to sour. Over 1,200 thrifts, many of which never fully recovered from the interest-rate crisis of the early 1980s, will fail in the 1985-95 period because of losses on their real estate loans.

Commercial banks have fared much better than thrifts. Almost 1,400 banks, most quite small, have failed over the past decade. However, the total cost of disposing of these failures will be about one-tenth to one-eighth of the cost of burying the dead thrifts. Most failed banks were struck down by various asset deflations over the past decade, including the collapse of farmland values in the early 1980s, the dramatic plunge in crude oil prices in the mid-1980s, and sharp drops in real estate values in many regions. Earlier bouts of overlending were an underlying cause of these deflations. The regulatory process was simply unable to stop them.

Deposit insurance losses have skyrocketed because of these failures. Consequently, the government's flat-rate tax on bank and thrift deposits, euphemistically called a deposit insurance premium, has soared. The sober drivers of the banking and thrift worlds are coughing up more and more for their deposit insurance to pay for the more expensive crashes caused by their drunken siblings. Mispriced deposit insurance also helped cause

Thomas E. Petri, *a Republican, represents the sixth district of Wisconsin in the U.S. Congress.* Bert Ely *runs a financial institutions consulting firm in Alexandria, Virginia.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Archive Photos/Lambert

The current system rewards risky lending while penalizing prudent banks.

a misallocation of real estate credit in the 1980s that will cost the economy as much as $500 billion in lost GNP by the end of this century, according to a recent study by the Congressional Budget Office.

More recently, escalating flat-rate deposit insurance premiums, coupled with an indiscriminate regulatory overreaction to the problems of the 1980s, have dampened the willingness of sound banks and thrifts to lend. Consequently, many businesses today cannot get the credit they need to help pull the economy out of recession. This is no way for an insurance system to work. When insurance losses rise, premiums should increase, but only for those whose actions mimic those causing the higher losses. Premiums should not increase for low-risk insureds.

FDIC Can't Do the Job

Recognizing the need for risk-sensitive deposit insurance premiums, Congress last year directed the Federal Deposit Insurance Corporation (FDIC) to begin charging a risk-sensitive premium by 1994. But the FDIC will never be able to calculate risk-sensitive premiums properly; accurate prices can be established only in private, competitive markets where many buyers and many sellers have many choices. In the case of insurance, this means many insurers and many seeking to be insured.

The FDIC, as it readily acknowledges, is a monopoly insurer. Thus, a bank or thrift under present law will have no opportunity to comparison shop or to find an insurer who understands the institution's uniqueness, and prices its deposit insurance accordingly. Instead, banks and thrifts unhappy with what the FDIC charges them, many of which will be riskier institutions, will complain to Congress. These complaints will quickly politicize this pricing process, just as happened in the 1980s when weak savings and loans often obtained congressional favors.

The FDIC understands the difficulty it faces in setting risk-sensitive premiums. Consequently, it will play it safe in two ways. First, it will charge premiums based on lagging measures of banking risk, such as non-performing loans, loan write-offs, and the amount of a bank's capital. These measures belatedly confirm that several years earlier the bank or thrift took some unwise risks. Compounding this sin, the FDIC will fail to sufficiently differentiate premiums between strong and weak institutions. Although badly managed and undercapitalized institutions should pay 15 to 20 times what the best pay, the FDIC has signaled that it will charge weak institutions only up to double what it will charge the strong.

Furthermore, prices based on lagging measures of risk serve only as a belated punishment, clearly a counterproductive exercise when a weak bank or thrift is struggling to recover. The FDIC, in studying the feasibility of charging risk-sensitive premiums, admitted as much when it stated that "these institutions may be required to pay higher insurance premiums [to the FDIC] at a time when they can least afford it."

Deposit insurance can be priced properly only by using leading indicators of banking risk to establish sharp premium differentials between well-managed banks and thrifts and those that are not. These leading indicators include taking risks without adequate compensation, not following sound procedures for granting loans and making investments, and lending in markets where overlending is raising the specter of asset deflation. Basing premiums on leading indicators of risk would deter a bank or thrift from taking more of the same type of risk, helping to steer it away from insolvency and failure long before it plunged off that cliff.

Competitive markets can tilt sooner against adverse trends in the general economy than can a monopoly government insurer ever fearful of being slapped down politically. An effective, market-based insurance premium would enable competitive insurers to operate much like forest rangers, in their watch-towers, responding to the slightest wisp of smoke before it turned into a raging fire. Insurers can raise premiums rapidly, or even prohibit certain types of risk-taking, while regulators can merely "tsk-tsk" about problems they perceive. The FDIC, like the rest of the increasingly cumbersome regulatory process, is politically prevented from responding to adverse economic trends until long after fire has engulfed the entire forest.

The Cross-Guarantee Concept

Deposit insurance, which has become an essential element of any sound financial system, in effect is an industry self-insurance mechanism administered by the FDIC. A 100 percent cross-guarantee system would shift the administration of this self-insurance mechanism to a competitive marketplace that would use sound insurance principles that the political process can never adopt. The cross-guarantee concept is incorporated in a bill before Congress this year, the Taxpayer Protection and Deposit Insurance Reform Act of 1992.

This shift would deliver many benefits. It would end all taxpayer risk in deposit insurance while fully and unconditionally guaranteeing all bank and thrift deposits, making them as risk-free as possible. It would lead to wiser credit allocation that would ensure more effective use of America's limited savings while steering banks and thrifts away from the overlending that can

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

trigger highly destructive asset deflations. It would promote a more efficient banking system. However, the act would not change existing restrictions on bank and thrift branching nor would it affect the types of activities in which banks, thrifts, and bank holding companies can now engage.

The 100 percent cross-guarantee alternative incorporates six principles:

- End all taxpayer risk in deposit insurance by ensuring that a network of well-capitalized private-sector guarantors stands ready at all times to protect all deposits in all banks and thrifts from any loss whatsoever.
- Let private markets set risk-sensitive deposit insurance premiums that would be paid directly to the private-sector guarantors of a bank's or thrift's deposits.
- Shift "safety-and-soundness" regulation and supervision to a bank's or thrift's guarantors.
- Shift the bank and thrift closure decision to these same guarantors. They should control the risk they have assumed because they would pay the bill if the bank were to become insolvent.
- Use a mandatory "stop-loss" mechanism to spread the bank insolvency risk widely, and therefore thinly, over $250 billion, or more, of equity capital that eventually would be committed to the cross-guarantee system. In effect, the stop-loss mechanism would construct a puncture-proof safety net under the banking system that would keep all bank and thrift insolvency losses in the private sector, thus keeping these losses out of the taxpayers' pocket.
- Retain federal deposit insurance as backup insurance, but only for deposits up to $100,000. This backup insurance would retain public confidence in banks and thrifts; however, it should never be called on.

Although nothing quite like the cross-guarantee concept exists, it has some effective antecedents. Lloyd's of London has operated as a risk-syndication marketplace for three centuries. Although Lloyd's has suffered from some internal governance problems in recent years, its strength as an insurer is still unquestioned. The act has been drafted to avoid the problems that Lloyd's is finally addressing.

A form of cross-guarantees protected bank deposits in Ohio, Indiana, and Iowa before the Civil War without any loss to depositors. However, these plans did not have risk-sensitive premiums. Had these plans not been driven out of business by national banking legislation enacted during the Civil War, cross-guarantee protection might soon have spread to the entire U.S. banking system. Along the way, risk-sensitive premiums probably would have evolved. Unfortunately, federal deposit insurance was modeled on 11 state deposit insurance plans that operated before the Depression, all of which failed when insolvency losses overwhelmed their limited resources.

Cross-Guarantee Contracts

The core of the cross-guarantee concept is a requirement that every bank and thrift obtain its own cross-guarantee contract issued by an *ad hoc* syndicate of guarantors. These guarantors can be other banks and thrifts or they can even be other types of entities, such as insurance companies (if permitted by their regulators), business corporations, foundations, pension funds, or even very wealthy individuals. Credit unions would not be required to obtain cross-guarantees; their existing insurance mechanisms would remain in place.

Each cross-guarantee contract, as a practical matter, would replace the uniform regulation of banks and thrifts now enforced by government regulators. In effect, shifting safety-and-soundness concerns from statutes and regulations to negotiated contracts would permit the marketplace to tailor a risk-sensitive premium rate and other contractual terms and restrictions to the needs and capabilities of each bank and thrift.

This flexibility would permit our financial institutions to better meet marketplace needs while actually strengthening the entire financial system. Premium rates and other contractual terms would not be subject to government regulation or approval. Because markets can experiment and adjust quickly to changing conditions, these premiums almost certainly would be based on leading indicators of banking risk designed to deter unsound banking practices.

Healthy banks and thrifts will be overcharged $5 billion to $6 billion this year for deposit insurance under the current system.

The Taxpayer Protection and Deposit Insurance Reform Act of 1992 builds numerous protections into the cross-guarantee process. The key protection would be a mandatory "stop-loss" requirement for each cross-guarantee contract. Stop-loss, which is similar to reinsurance, is widely used in the insurance industry. Under the stop-loss requirement, any guarantor whose cross-guarantee losses exceeded five times the total amount of cross-guarantee premiums it collected over the previous 12 months could pass those losses through to its own guarantors. Losses up to the amount of the stop-loss limit would be less than the annual pre-tax earnings of most guarantors.

In effect, the stop-loss limit is a circuit-breaker that would prevent a guarantor from ever becoming insolvent because of its cross-guarantee activities. However, a guarantor would feel financial pain if it assumed too many underpriced or poorly monitored risks. Guarantors that are not banks or thrifts would have to enter into special stop-loss contracts that would incorporate the same type of circuit-breaker.

Various risk-dispersion requirements also have been built into the act. Each cross-guarantee contract must have a minimum number of guarantors, each of whom could assume no more than a limited amount of the risk. For example, any bank or thrift with more than $10

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

billion of assets must have at least 100 guarantors, none of which could assume more than 1 percent of the risk under that contract. At the same time, guarantors will be limited, based on their own capital, as to the total amount of cross-guarantee risk they could assume as well as the risk they could assume under any one contract.

Cross-guarantee contracts could not be canceled unless the guaranteed bank or thrift had first obtained a replacement contract or had been acquired by another institution. Guarantors would be authorized to take over the institution if it failed to obtain another contract or a merger partner.

In effect, existing guarantors would be on the hook until their risk had been assumed under another cross-guarantee contract. This provision of the bill reflects a very important principle: Once a bank or thrift obtains a cross-guarantee contract, it can never again operate without a contract. This principle also holds true when a cross-guarantee contract expires—the existing guarantors would continue to bear the cross-guarantee risk until the guaranteed institution obtained a new contract.

Syndicate Agents and Regulation

Each cross-guarantee syndicate would be required to retain an independent firm, called a syndicate agent, to monitor the financial condition of the guaranteed institution on behalf of the syndicate. In practice, the syndicate agent would play a key role in assembling the syndicate and in negotiating the contract. On an ongoing basis, the syndicate agent would ensure that the guaranteed institution adhered to the terms of the cross-guarantee contract.

The independence of the syndicate agent would ensure that it could protect the competitive secrets of the guaranteed bank from its guarantors, some of whom may also be competitors. However, the syndicate agent would have an unambiguous fiduciary obligation to the guarantors to apprise them of the overall condition of the bank or thrift. The syndicate agent's independence also would alleviate the concern that cross-guarantee syndicates would foster anti-competitive behavior among banks.

A "stop-loss" requirement for each cross-guarantee contract would protect taxpayers from all deposit insurance losses.

The 100 percent cross-guarantee concept has been designed to be as self-regulating as possible. The FDIC would regulate the process, primarily by reviewing every cross-guarantee contract to ensure that there were no exceptions to the stop-loss requirement and that all guarantors had met the risk-dispersion and risk limits set out in the act. In effect, FDIC oversight would focus on maintaining the safety, soundness, and viability of the entire process by assuring the integrity of every cross-guarantee contract. It would *not* act to protect the solvency of any one bank or thrift—that would be the sole concern of its cross-guarantee syndicate.

Although cross-guarantees would fully protect all deposits against conditions more adverse than the Great Depression, the act would create the Cross-Guarantee Backup Fund, or BUF, explicitly to provide federal protection for deposits up to the present $100,000 insurance limit. An assessment on explicitly insured deposits would build a small balance in the BUF. Quite frankly though, the BUF would experience a loss only if the FDIC permitted a hole to develop in the stop-loss safety net. This should never happen. The presence of the BUF would allow banks and thrifts to continue to display the FDIC insurance logo. They also could display a second logo stating that *all* deposits in the institution were fully protected against loss under an FDIC-approved cross-guarantee contract.

Deterring Unwise Banking

Because risk-sensitive premiums would deliver low premiums to well-run banks, banks would have an enormous incentive to manage their affairs wisely. However, if an institution began to engage in unsound banking practices, leading indicators of banking risk would detect these practices and the bank's premium rate would begin to rise. Most of the time the bank or thrift would then take corrective action and its premium rate would soon decline.

If a bank or thrift did not reform itself, and it was publicly owned, the higher premium rate would begin to depress its stock price. This price decline usually would trigger "equity market intervention" in which new capital is invested in the bank in return for a share of the resulting premium savings. Providers of the new capital undoubtedly also would demand management changes and improved banking practices.

If the bank's or thrift's downhill slide continued, contractual provisions eventually would enable the guarantors to take over the institution and sell it, hopefully without any loss to the guarantors. Occasionally, though, there would be a loss that guarantors would pay for from their premium income. It would be a rare event, however, when a guarantor paid out more in losses during a year than it collected in premium income, which is why guarantors would assume cross-guarantee risks: to make a profit. If a guarantor's losses exceeded five times its total premium income, then the stop-loss feature described above would kick in and losses over the five-times limit would be shifted to the guarantor's own guarantors.

Transition to Cross-Guarantees

It would be impossible to shift every bank and thrift to cross-guarantee contracts at the same time. Therefore, the act sets out a minimum nine-and-one-half-year timetable to achieve this transition. However, no bank or thrift would be permitted to switch to cross-guarantees until 18 months after the act became law or when "critical mass" had been reached.

Critical mass would have occurred when at least 200

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

banks and thrifts owning at least $500 billion in assets had obtained cross-guarantee contracts approved by the FDIC. If critical mass is never reached, then the cross-guarantee concept would have failed in the marketplace and would never be activated. Bank and thrift regulation and federal deposit insurance would continue as if this act had never been enacted.

Once the first cross-guarantee contracts had become effective, all remaining banks and thrifts would have up to eight years to obtain their own contracts. Institutions with more than $1 billion in assets would have two years after the effective date to obtain a contract; those with less than $25 million in assets would have up to eight years. This generous timetable would give weaker banks and thrifts ample time to raise the capital they needed to obtain a cross-guarantee contract or to merge with a stronger institution.

As banks and thrifts became guaranteed, they would pay a severance fee to the FDIC to fund the downsizing of the bank regulatory establishment, specifically severance compensation for employees leaving the regulatory agencies. If needed, institutions obtaining cross-guarantees also would pay an exit fee to cover any losses the FDIC incurred in disposing of the few banks and thrifts that could not raise sufficient capital to become guaranteed or to find a merger partner.

The cross-guarantee concept is designed to provide banks and thrifts with ample choices among prospective guarantors. This is why non-banking firms would be authorized under the act to participate as guarantors. Creating a large pool of potential guarantors would protect banks from premium overcharges, end concerns about capital adequacy in the banking system, and permit guarantors to accept or reject individual cross-guarantee risks as they saw fit. There would be no need therefore for the federal government to act as a guarantor to meet perceived shortages of cross-guarantee capacity or to force any bank or thrift to be a guarantor of another institution.

Although there should be no bank runs, cross-guarantee contracts would protect any loan a Federal Reserve bank made to a guaranteed institution. Thus, the Fed could still be involved in helping to maintain public confidence in America's banks and thrifts, but again without any risk to taxpayers.

Perestroika for Banking

The cross-guarantee concept represents a win-win proposition for the taxpayer, well-managed banks, bank customers, and the American economy. Cross-guarantees would sharply reduce deposit insurance losses by deterring banks from unwise banking practices. Prudent banks would be rewarded with much lower deposit insurance premiums. Badly managed banks would pay for the damage they potentially could cause; in most cases risk-sensitive premiums would force the reversal of unwise practices within a bank or thrift long before it failed. Risk-sensitive premiums therefore would bring more efficient banking to America, lower interest rates for good borrowers, and prevent future banking crises.

Photofest

Market-based premiums would enable insurers to operate like forest rangers, responding to the slightest wisp of smoke before it turned into a raging fire.

Using private-sector capital to guarantee all deposits while providing backup federal insurance for deposits up to $100,000 also would eliminate the too-big-to-fail problem (using federal deposit insurance to protect all deposits in a failed bank considered to be too big to liquidate). Cross-guarantees also would bring greater stability to our financial system yet shrink the federal safety net, as represented by federally insured deposits. Depositors would grow accustomed to cross-guarantees and stop spreading their deposits among numerous institutions to obtain more federal deposit insurance coverage. The cross-guarantee concept would permit individual banks and thrifts to safely pursue customized business strategies that would enable the banking and thrift industries to more efficiently meet America's banking needs. The present regulatory structure, with its one-size-must-fit-all mentality, limits the ability of individual banks and thrifts to meet specialized banking needs, such as providing banking services in minority or low-income neighborhoods.

Cross-guarantees would help community banks to continue playing an important role in American banking. No longer would they be at a competitive disadvantage in attracting deposit balances over $100,000 because the too-big-to-fail policy now only protects all deposits in larger banks. Also, community banks would benefit from lower deposit insurance and regulatory compliance costs.

Franklin Roosevelt's warning about the dangers of federal deposit insurance was correct, as we have learned to our sorrow. Yet America needs a sound deposit insurance system. The 100 percent cross-guarantee concept would use market-driven deposit insurance premiums to promote wise bank lending and investing, while protecting all deposits without placing the taxpayer at risk.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Victorian Secret

Pro-Life Victories in 19th-Century America

Marvin Olasky

America's pro-life movement has a great deal to learn from its forefathers of a century ago. The rate of abortion probably fell by over half from 1860 to 1910, as pro-life leaders followed a successful containment strategy sharply different from the millennialist, all-or-nothing spirit of segments of the pro-life movement today.

Although many pro-lifers think of abortion as an inheritance from the 1960s, the practice was as proportionately frequent on the eve of the Civil War as it is now. There were roughly 160,000 abortions in 1860 in a non-slave population of 27 million. (The numbers among slaves are unknown.) This was almost the equivalent of our current figure of 1.6 million abortions in a population of close to 250 million.

The number of abortions continued to rise during the second half of the 19th and the early years of the 20th centuries, but the increase was much smaller than the growth of population. By 1910 there were roughly 200,000 abortions in a total population of 92 million. Were abortions as common in 1910 as in 1860, there would have been over 500,000 in the latter year.

The development of diaphragms and rubber condoms in the late 19th century was partly responsible for the falloff in abortions, especially among prostitutes. But birth control devices were not widely used in America until the 20th century. The falloff in abortions thus took place mostly before the contraception revolution. It owed much to a pro-life movement that offered young women alternatives to sex before marriage, and, when that strategy failed, provided refuge for the unmarried and pregnant who saved their babies' lives by placing them for adoption.

One reason opponents of abortion a century ago were more successful than today's pro-life movement was that they realized this is a fallen world and were therefore content with a series of many small victories. They did not demand that abortion be legislatively designated as murder, but worked for penalties that were sustainable in public opinion and in the jury box. They appreciated the educational impact of anti-abortion laws but did not expect much in the way of enforcement, and instead concentrated on ways to provide women with alternatives to abortion. They were not laid low by a sense of failure when, despite their efforts, many unborn children died. They rejoiced that so many were saved.

Pilgrims' Regress

The recorded history of abortion in America dates from the earliest English settlements. Captain John Smith, famous for being befriended by Pocahontas, heard depositions about an abortion in 1629; the alleged perpetrator, Dorcas Howard, an unmarried servant, was let off because of insufficient evidence. In 1652, on the insistence of Lord Baltimore, William Mitchell had to resign from the Maryland governor's council after he was convicted of forcing his pregnant maidservant, Susan Warren, to ingest a chemical substance designed to induce abortion. Mitchell was also fined 5,000 pounds of tobacco.

Maryland archives in the Library of Congress show other abortion cases in 1656 and 1663. Both, significantly, involved maidservants forced to it by their masters. Massachusetts court records show abortions in 1678, 1681, and thereafter: those first two, and almost all the others, involved unmarried women impregnated and abandoned. Given the great physical risks of abortion to the mother at the time, infanticide was more frequent than abortion, but records show both were practiced in Connecticut, New York, and points south.

Abortion was condemned by colonial clergymen. Minister Benjamin Wadsworth, later president of Harvard College, declared in 1712 that abortion was "murder in God's account." The practice was contained mainly by religious and social pressures that insisted on marriage in the event of pregnancy.

By the 1760s, among the non-slave population, as many as one of every three Americans was conceived out of wedlock, but only one out of 15 was a bastard at birth. Whenever the identity of the father of the unborn child was clear, the father could choose between marriage,

Marvin Olasky, *associate professor of journalism at the University of Texas, Austin, was 1990–1991 resident scholar with Americans United for Life. His forthcoming book,* Abortion Rites: A History of Abortion in America, *will be published by Crossway.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

disgrace (with forced payment of child support anyway), or flight to another colony under an assumed name. Most men chose marriage.

For those unborn children at greatest risk, with no paternity established, another form of containment at least prevented dire poverty. An unwed mother could assert that a particular man was the father, and if it was proven that he had slept with her—even if others had also—he had to pay child support through the first 12 years of life.

As a back-up to social pressures, many colonies developed statutory proscriptions on the concealment of birth, a practice closely related to abortion and infanticide, and some local ordinances also made abortion more difficult. New York City in 1716, for example, enacted an ordinance that forbade midwives to aid in or to recommend abortion, and thus severely limited access to abortion services. These types of regulations helped to contain, but not eliminate, abortion.

"The Evil of the Age"

Early in the 19th century, the system of containment broke down as urbanization, increased mobility, and theological liberalism made it easier in practice and conscience for men to inseminate and run. A men's rights movement attacked shotgun marriages and child-support payments on a woman's say-so, and court records show a slow increase in desperate cases of abortion and infanticide.

Prostitution became much more common from 1830 to 1860. Without reliable contraception, prostitutes typically used abortion as their birth control, sometimes several times a year, and often with drastic physical repercussions for mother as well as child: the average prostitute died within four years of joining the trade. Reliable estimates from 1860 show 60,000 prostitutes becoming pregnant and having abortions.

The "spiritism" craze in many northern cities during the 1850s also led to an abortion increase. Hundreds of books from the decade describe the channeling of spirits during weekend retreats, seances, and other meetings attended regularly by several million people. The

The abortion rate, as high in 1860 as it is today, fell by more than half by 1910.

"spiritists" claimed absolute freedom from earthly conventions such as marriage. When adultery among 19th-century New Agers led to unwanted pregnancy, for the first time in American history thousands of married women were having abortions. Dr. Benjamin Hatch wrote in 1859 how married women from the "fashionable and intellectual communities...live in adultery, produce abortion, arise from their guilty couches, stand before large audiences as the medium for angels...and boasting-

Archive Photos

The history of abortion in America dates from the earliest English settlements of Captain John Smith.

ly speak of their freedom from what they call social conventionalism and the superstitions of Christianity."

By 1860 abortion was not part of the American mainstream, as pro-abortion historians contend. It was limited mostly to those on particular sidestreams: victims of seduction, prostitutes, and spiritists. Even so, these populations were sizeable. Leading newspapers contained thinly veiled ads for abortion drugs and operations. In 1867, 61 percent of the ads in the medical column of the *New York Herald* were abortion-related. Abortion was risky for women—perhaps one in 20 died during the process—but lucrative for abortionists. New York's famous Madame Restell secured political protection through bribery and blackmail and built a millionaire's mansion on Fifth Avenue.

Abortion was so extensive in the mid-1800s that the *New York Times* called it the "Evil of the Age" in a major work of investigative reporting in 1871. "The enormous amount of medical malpractice [a euphemism for abortion] that exists and flourishes, almost unchecked, in the city of New York, is a theme for most serious consideration," wrote the *Times*. "Thousands of human beings are thus murdered before they have seen the light of this world."

"Rose Water Balderdash"

The abortion rate began to fall after the Civil War, as a nationwide pro-life movement gathered strength. The movement included the Women's Christian Temperance Union (WCTU), the YMCA and YWCA (Young Men's or Women's Christian Association), the Societies for the Suppression of Vice, and, by the end of

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Bettmann Archive

With the "spiritism" craze of the 1850s, thousands of married women began to have abortions.

the century, the Salvation Army. Many doctors were involved; unlike today, the American Medical Association was a staunch opponent of abortion, which it dubbed "unwarrantable destruction of human life." But the most important part of the movement was a network of locally based shelters providing homes for single women to keep them out of trouble, and refuges for those who got into trouble anyway.

Although many pro-life leaders had religious motivations, their movement was not primarily based in the churches. Catholic bishops in New York, Boston, and Baltimore denounced abortion but evidently did not excommunicate abortionists. A few individual Protestant ministers, but only one denomination, the Presbyterian Church in the United States of America, condemned the practice. Newspapers criticized most clergymen for remaining silent: "Would that we might hear some strident tones from the pulpits about this phase of the evil," wrote the *National Police Gazette*. When a churchgoing woman died during an abortion, her minister was blamed by the *Gazette* for having offered "rose water balderdash" and "cream-cheese platitudes" on abortion rather than strict warnings. Then as now, theological radicals such as Henry Wright argued that a child's "first claim is to a *designed* existence, if it is to exist at all." Some said "it was less criminal to kill children before they were born, than to curse them with an unwelcome existence."

The pro-life leaders rejected the premise that an "unwelcome existence" was the only alternative to abortion. They looked at the three groups of women most likely to have abortions and offered programs of education, refuge, and adoption that would help women to avoid unwanted pregnancy or to recover from it, without hurting a child.

Sex and the Single Woman

The first at-risk group, young women on their own in big cities, received the greatest attention. The female labor force outside the home increased from 2.6 million to 10.8 million between 1880 and 1930; more unmarried young women were moving to cities and living apart from immediate family or relatives, often in boardinghouses. There they were exposed to many new ideas about behavior, and many opportunities to act on the ideas. At the same time they were subject to moral expectations young men could escape: a man could go "astray in his youthful prime" and still be accepted, but when a woman "followed blindly where fond love led," she was confronted by an unforgiving double standard.

Many groups at the time tried to educate men into a greater sense of responsibility. Organizations such as the White Cross Society, influential in the 1880s, pressed men to "treat the law of purity as equally binding on men and women." Thousands of men signed pledges promising chastity and affirming "the unity of the moral law for both sexes." The WCTU, then the largest women's organization in the United States (its membership reached 245,000 in 1911), tried to teach men about self-control in sexual as well as alcoholic pursuits. There was much talk of increasing men's financial responsibility in case of pregnancy and enforcing child-support payments. Women's groups talked frequently of abstinence and published millions of booklets and tracts.

Such education changed some men's behavior. But the turn-of-the-century files of one Boston charitable organization show its limitations. Case 12: "This girl met the alleged father of her child, a young man of 19, at the home of a friend....she believed him when he promised to marry her if she became pregnant. Instead of doing this, he deserted her as soon as he learned of her condition." Case 19: "This girl had known the father of her child, a young machinist of 25...and had associated with him for three months before allowing him to be sexually intimate with her, finally acquiescing, according to her own story, only after much pleading on his part...he deserted her when he learned of her condition."

For the most part WCTU leaders and others concluded that they could not eliminate the double standard; instead, they would have to teach young women to be skeptical of men's honesty. Trust the marriage license, they said, and not honeyed words from those who could walk away into urban anonymity.

A Refuge Away from Home

Not everyone followed this advice, of course; young women, abandoned by boyfriends and often unable to go home again needed a refuge. By 1895 Chicago had a dozen shelters for the pregnant and unmarried, including the Life and Hope Mission, the Rescue Mission, Beulah House, the Jewish Home for Girls, and Boynton Refuge Home. Some refuges were small, but one, the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Home for the Friendless, cared for 1,291 women in 1893. Other cities showed a similar pattern. In Minneapolis, Bethany Home and the Norwegian Home of Shelter were among the active refuges; city investigators reported that "the girls are placed under wholesome moral influences and given practical and industrial training. In each the religious motive is emphasized...but in each, girls of all faiths are received without discrimination."

The greatest center of trouble and help, as could be expected, was New York City. Some agencies worked toward prevention of unmarried pregnancy by providing group lodging and affiliation for young women who would otherwise be alone and vulnerable; among these were the National League on Urban Conditions Among Negroes, the Association for Befriending Children and Young Girls, the Free Home for Young Girls, and the New Shelter for Young Women. Unmarried pregnant women were offered lodging, help, and training by at least 20 groups, including the Magdalene Benevolence Society, the House of Mercy, and the House of the Good Shepherd (with room for 1,042 women).

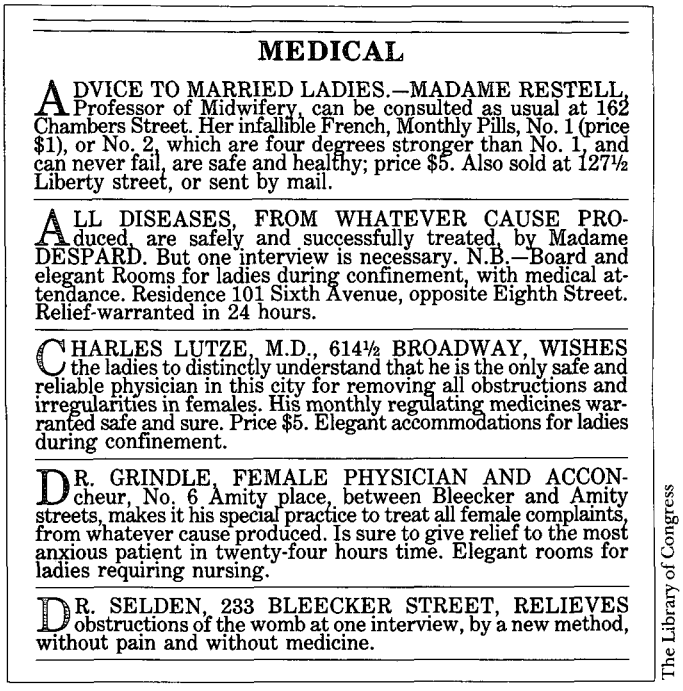
National organizations also were active. Florence Crittenton homes—the number grew to 65 by 1927—helped 500,000 unmarried women between 1883 and 1933. The Salvation Army had 34 homes for unmarried mothers, the WCTU's Department of Rescue Work had at least five, the Protestant Episcopal Church had 12 "Homes of Mercy," and the "Door of Hope" group had 40 homes for young women "built in hopes of not simply sheltering and furnishing them with employment, but through love and sympathy to lead them to a Christian life."

The American Medical Association, unlike today, called abortion the "unwarrantable destruction of human life."

The stories across the nation are similar: A refuge found and a child's life saved. Some typical monthly reports in the Chicago Historical Society read: "E.L. is 19 years of age...anxiously looking each day for the young man who has promised to come and marry her....E.A. was 'betrayed by promise of marriage,' the old story, nonetheless sad though too frequent...S.B. is a young girl, 16 years old. She has been betrayed....one child was adopted. Little Earl had found a home with a kind-hearted and lonely woman....Two infants were adopted last month, good homes being provided for them....A good home is provided for C.S.'s child, Jane...."

Adoption, Not Abortion

A century ago, as the reports show, those contemplating a quick fix were asked to think about adoption instead, and then compare their own months of trouble with the years of good life that their children could have. Single motherhood was not seen as a realistic option, and there was no shortage of families willing to adopt. An 1895 study of Chicago adoption groups such as the Children's Aid Society and the Foundlings' Home concluded, "the children generally remain at the homes but a few weeks, there being more calls for their care and adoption than the supply can meet."



MEDICAL

ADVICE TO MARRIED LADIES.—MADAME RESTELL, Professor of Midwifery, can be consulted as usual at 162 Chambers Street. Her infallible French, Monthly Pills, No. 1 (price $1), or No. 2, which are four degrees stronger than No. 1, and can never fail, are safe and healthy; price $5. Also sold at 127½ Liberty street, or sent by mail.

ALL DISEASES, FROM WHATEVER CAUSE PRODUCED, are safely and successfully treated, by Madame DESPARD. But one interview is necessary. N.B.—Board and elegant Rooms for ladies during confinement, with medical attendance. Residence 101 Sixth Avenue, opposite Eighth Street. Relief-warranted in 24 hours.

CHARLES LUTZE, M.D., 614½ BROADWAY, WISHES the ladies to distinctly understand that he is the only safe and reliable physician in this city for removing all obstructions and irregularities in females. His monthly regulating medicines warranted safe and sure. Price $5. Elegant accommodations for ladies during confinement.

DR. GRINDLE, FEMALE PHYSICIAN AND ACCONcheur, No. 6 Amity place, between Bleecker and Amity streets, makes it his special practice to treat all female complaints, from whatever cause produced. Is sure to give relief to the most anxious patient in twenty-four hours time. Elegant rooms for ladies requiring nursing.

DR. SELDEN, 233 BLEECKER STREET, RELIEVES obstructions of the womb at one interview, by a new method, without pain and without medicine.

The Library of Congress

***New York Herald*, 1865. Leading newspapers contained thinly veiled ads for abortion drugs and operations.**

In smaller cities as well, pro-life forces made adoption a priority. At a WCTU refuge in Elmira, New York, over two-thirds of the babies born between 1890 and 1907 were adopted. One southerner, Lem Abbott Odom, spent 50 years managing refuges in Montgomery, Alabama; Jacksonville, Florida; and Shreveport, Louisiana. Odom recommended that unmarried mothers who could not marry the fathers place their children for adoption; about 85 percent of the young women he helped were able to marry or to be restored to "homes, gainful occupations, and positions of trust...."

Modern Magdalenes

Careful focusing also was evident in attempts to help women from the second at-risk group, prostitutes. In 1891, a Chicago bookkeeper could trade her salary of $8 per week for "massage parlor" work that paid $10–$12 week, plus another $20 in tips for full-fledged prostitution. A Cincinnati woman could trade a $5-per-week starting factory wage for $25 to $30 a week as a prostitute. So anti-prostitution reformers knew there was an economic as well as a moral component of the problem.

Reformers preached and wrote about how sin was crouching at the door of many tenements, but they also warned young women to watch out for brothel recruiters who might trick and then trap them. Some 28 Girls' Protective Leagues in New York City enrolled 2,500

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Museum of the City of New York

Children dancing after the death of abortionist Madame Restell, outside her Fifth Avenue mansion.

members who were given a "blacklist of dangerous places" and who learned the importance of spurning "improper proposals when applying for positions through newspapers and employment agencies."

Pro-lifers could not do much about the low wages characteristic in entry-level jobs at the time, but they reduced the cost of living and increased safety by setting up networks of family-style lodging houses and inexpensive, YWCA-type boarding houses where decent rooms were available for $1.50 per week.

To women already deep into prostitution, opponents of abortion spoke of repentance, forgiveness, and help in crossing over. Evangelists such as Dwight Moody made sure they had names and addresses of families willing to provide a spare room in their homes to young prostitutes who found themselves pregnant and chose to leave the trade. Hardened hookers who were pregnant and did not want one more abortion frequently went to refuges. In New York, the House of the Good Shepherd offered shelter and help for women "who wish to reform their lives by deserting the haunts of vice [or] may be in danger of falling." Lakeview Home, operated by an association of Jewish women, provided industrial training, personal counseling, and care for 25 young women and up to 25 infants. The Home of the Good Samaritan, like many other refuges, found jobs for women "living in sin and desirous of leaving their old life." Spiritual challenge was always essential: the Erring Women's Refuge, according to one woman who went there, was the "first place I ever lived that any person cared enough about the salvation of my soul to make it a matter of interest to me."

Post-Abortion Syndrome

Pro-lifers concerned with the third at-risk group, married women liberated from biblical principles by "spiritism" or some other creed, proposed many means of containment, but two stand out. First, they tried to describe accurately what an unborn child looked like: women were to know that they were not only breaking a law, but breaking a tiny heart as well. Second, they emphasized the physical dangers of abortion to women—an effective appeal to those not choosing abortion in desperation—and also the psychological effects.

The psychological stress is particularly interesting, because supporters of abortion have charged that "post-abortion syndrome" is a recent invention of anti-abortion forces. And yet, in 1875 feminist Elizabeth Evans was describing the effects of abortions on women who had them a decade or two before. One woman, she reported, was "wild with regret at my folly in rejecting the (alas! only once-proffered) gift of offspring." Another woman described how her "thoughts were filled with imaginings as to what might have been the worth of that child's individuality; and especially, after sufficient time had elapsed to have brought him to maturity, did I busy myself with picturing the responsible posts he might have filled." This sad lady added that she never "read of an accident by land or by water, or of a critical moment in a battle, or of a good cause lost through lack of a brave defender, but my heart has whispered, 'He might have been there to help and save; he might have been able to lead that forlorn hope; his word or his deed might have brought that wise plan to successful issue!'"

Pro-life forces distributed gripping accounts of psychological damage. "I was for a long time as near as being insane as one can be without really going mad," one woman recalled. "I had an idea that I had lost, through that unnatural deed, the normal powers and qualities of a human being. I no longer ate and drank with the old hunger and thirst, nor slept the quiet sleep of innocence; I took no heed of the passage of time, and all that I saw and heard seemed to be the occurrence of a dream, as though life was already finished for me."

By the 1870s, every state had anti-abortion laws. But mothers were virtually never punished, and few abortionists were convicted.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Other women told Evans similar stories, and she concluded that "the enormity of the crime of foeticide may be, in some degree, estimated by the excessive remorse which, sooner or later, is sure to follow its perpetration."

Laws with a Message

Laws against abortion assisted the pro-life movement, but were not the primary focus of its attention. Beginning with Connecticut in 1821, state after state passed increasingly tough laws against abortion, with exceptions to save the life of the mother. Most of these laws were enacted in the mid-1800s. And by the 1870s, every state had anti-abortion laws. Abortion was not, however, a capital crime, and the mothers were virtually never punished. The typical punishment for an abortionist was a few years in prison.

Even so, very few abortionists were convicted, as prosecutors and judges ran up against special evidentiary problems. In 19th-century abortion trials the state had to prove three things: an actual pregnancy, a live unborn child at the time of the abortion, and the death of that child caused by the abortion. The pregnancy itself could not be proven until quickening, and the continued life of the child up to the time of abortion could only be vouched for by the mother or others who had placed their hands on her body. Autopsies are critical in homicide cases—a murder trial without a corpse is hard to win—but abortion cases (when the mother survived) almost never had a corpse, an autopsy, or witnesses. Almost all abortion evidence was secondhand, and when dying declarations were used, a kind of hearsay.

Thus New York's secretary of state reported only nine convictions for abortion in the entire state from 1895 through 1904, a decade in which there were at least 90,000 abortions in the state. Even though few abortionists were convicted, law was not useless. Anti-abortion statutes sent clear messages of right and wrong. They made the merchandising of abortion far more difficult: in the mid-19th century abortionists had to advertise in code, bribe policemen and politicians, and at times hire expensive lawyers. Pro-life groups sometimes hired detectives and attorneys to prove that a doctor offering to help women "in trouble" was performing abortions. The abortionists then had to lie low, and some even served a little jail time. Law could not end abortion, but it could aid in containment, in making sure that the sidestreams did not become the mainstream—just as laws against drunken driving today cannot end the practice, but can save lives.

Pro-lifers did not always agree on legal strategy. When one judge in 1871 proposed that abortion be considered "murder in the first degree, and punishable as such with death," he initially received loud applause. Members of the Medico-Legal Society of New York, however, argued that a death penalty for abortion "would probably result in lessening the chances for a conviction in any case." The society expressed no leniency concerning abortion—its members reported that the judge's view of abortion as a "capital felony" was "intrinsically just"—but saw a death penalty as unsustainable. The New York legislature eventually approved an abortion sentence of four to 20 years.

The attempt to make penalties socially acceptable sometimes meant a lower range of punishment (in Pennsylvania up to three years) for abortion before quickening; those cases did not provide the certainty of pregnancy that made people willing to put away an abortionist for a long period of time. Many states gave immunity to women from all criminal liability, partly because women pregnant after seduction were considered desperate victims rather than perpetrators, and partly to attain any kind of edge in prosecution. Other states, such as New Jersey and New York, gave women immunity from prosecution in exchange for testimony. Dr. Edward T. Abrams, a pro-life member of the Michigan legislature and chairman of its committee on public health, noted that "there would be no more powerful inducement for the concealment of abortion than to make a woman a party to the criminality of the act, because it will destroy absolutely the method of getting evidence."

The most important part of the pro-life movement was a network of shelters and refuges for women.

Safe To Be Conceived

As a result of the pro-life strategies, the abortion rate declined dramatically, and stayed relatively low through 1960. The pro-life leaders at the turn of the century understood that there never would be "total abolition of the practice." Abortion, they knew, was "an evil which has existed through all time and will continue to exist," but it could be limited.

And it was limited. Throughout the first six decades of the 20th century, unmarried young women often placed children for adoption or, during pregnancy, married the father. Abortion among the married was low, except in iconoclastic neighborhoods such as New York's Greenwich Village and, perhaps, among several immigrant populations. Meanwhile, contraceptive improvements reduced the use of abortion as a form of birth control. Even though abortion by the 1950s was much less physically hazardous for the mother than ever before—the advent of penicillin helped immensely—decreased danger did not immediately lead to increased usage. In all, the 1950s was probably the safest time to be conceived in American history.

New Nurturing Networks

The abortion rate is beginning to fall again today, although still only slightly. The number of abortions is holding steadily at 1.6 million a year, but the number of births has grown during the past decade—from 3.6 million to 4 million per year. A 19th-century-style pro-life

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Bettmann Archive

The Women's Christian Temperance Union, then the nation's largest women's organization, tried to teach men self-control in sexual as well as alcoholic pursuits.

movement has emerged among the volunteers at several thousand crisis pregnancy centers who have opened up their homes, provided material help and spiritual challenge, and done many other things in the face of defamation campaigns waged against them by the abortion lobby. Meanwhile, a small number of pro-life lawmakers and legal experts are working in the 19th-century tradition to develop sustainable legislation that will restrict abortion even it if does not eliminate it entirely.

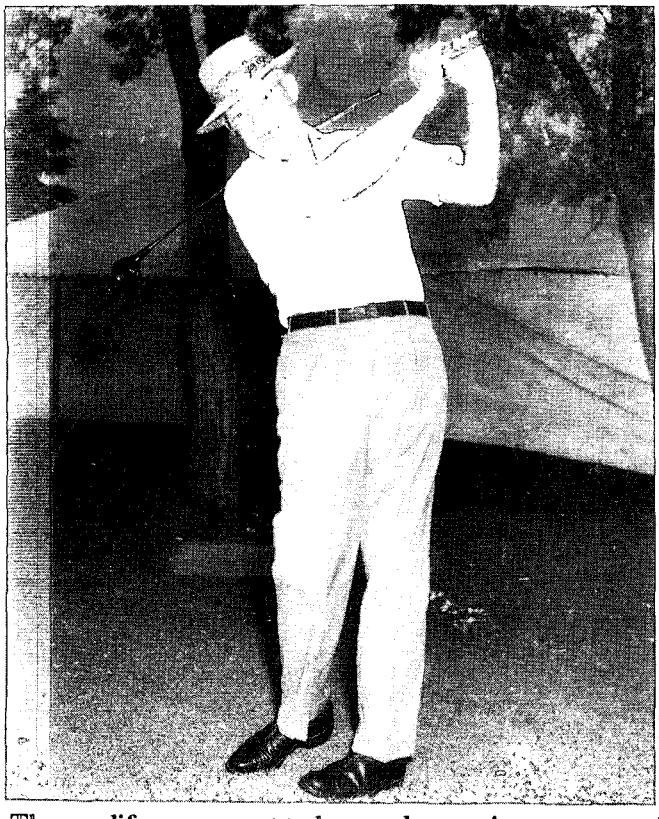
All of these "moderate" advocates of life sometimes face attack not only by the abortion lobby but by those pro-lifers who stand with a few short ladders outside a towering inferno and cry, "no exceptions." For example, "adoption, not abortion" is the most potent slogan the pro-life movement has, and Michigan Right-to-Life has recently conducted a successful television advertising campaign on that point. But such an approach is insufficiently radical for some. New groups such as the Nurturing Network have shown initiative in targeting specific abortion-prone segments of the population (young professional women desperate to avoid career-sidetracking, for example), but others have been content to repeat an "abortion is murder" mantra.

Some dedicated opponents of abortion continue to waste their energies and stock of potential good will in a mad dash that ends first at a brick wall, and second, as frustration grows, in either extreme action or a long winter's nap. "Ultra" pro-life thinking is partly the result of theological errors (including a superficial view of evil) and juvenile millennialism (non-negotiable demands, now)—but it also emerges from historical ignorance. Some pro-life leaders like to equate their movement with that of the abolitionists, but they choose the wrong heroes. Men such as John Brown helped to precipitate a tragic civil war in which 600,000 died, and former slaves found their new-found freedom abridged by sharecropping, lynching, and the Ku Klux Klan.

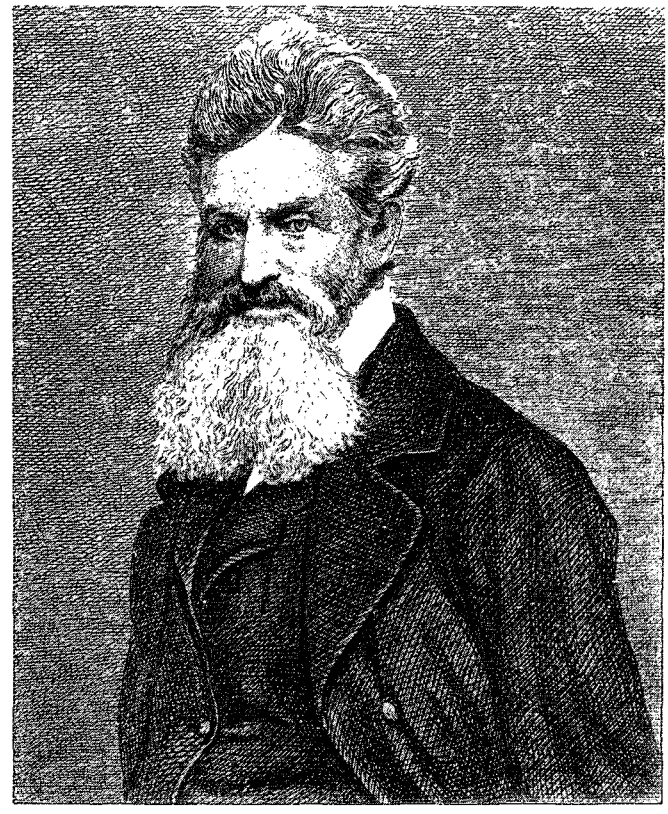
Containment Policy

A better model for the pro-life movement now would be the containment policy that the United States successfully used against the Soviet Union from the late 1940s through 1991. The containment policy, as skillfully enunciated by George Kennan in his famous *Foreign Affairs* article of 1947, stressed that the United States should avoid military adventures but should concentrate on the "long-term, patient but firm and vigilant containment of Russian expansive tendencies." Kennan understood that it was not unusual for dictators to emerge, but it was dangerous to have a web of ideology and tyranny that extended so far. He understood that "Soviet power... bears within it the seeds of its own decay, and that the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED



AP/Wide World Photos



The Bettmann Archive

The pro-life movement today needs containment strategists like Eisenhower (left), not abolitionists like John Brown.

sprouting of these seeds is well advanced."

Proponents of containment did not have it easy. Some Americans criticized the approach because it did not kill Communism immediately. Some demanded military action and argued that it was immoral to leave hundreds of millions of souls in a totalitarian hell while life went on in America. Containment doctrine was embraced by Harry Truman and Dwight Eisenhower and maintained by the United States, despite some wavering in the 1970s, for 40 years. Now that the West has won, all of us can see how immoral it would have been to resort to war for a slim chance to achieve ends, at enormous cost, that were attainable with peaceful perseverance.

The pro-life movement today needs Eisenhowers, not John Browns. It needs leaders who understand that, in America, there has always been some abortion among women seduced and abandoned by men, money, or the religion of self. That is sad, but the tragedy becomes gargantuan only when those three groups expand to become part of an evil empire, and when those on the outskirts of the groups come to consider abortion normal. The pro-life goal should be to help Americans see abortion not as a right but as a non-normative practice engaged in by sidestream groups and not given societal approval. As abortion is contained in that way, legal changes and compassionate alternatives will reduce the likelihood of abortion being used as a desperate recourse.

The hope with containment, of course, is that it is the first step to rollback. Who would have dreamed that the Soviet empire, after decades of constant pressure, would finally fall so fast? But it did. And that is why a doctrine of perseverance is not depressing for those who have a biblically realistic view of human nature and a trust in God's timing and justice. The abortion empire can begin to fall only if it faces steady pressure over decades through all the means that worked a century ago and are beginning to work anew: education about abstinence, refuges for the abandoned, and provision of adoption and many other services.

Pro-lifers now have one big advantage over their predecessors: wonderful photographs of unborn children at every state of gestation. Whittaker Chambers dated his initial break with Communism to the time his young daughter smeared porridge on her face. Chambers found himself looking at her "intricate, perfect ears." He saw immense design, not a chance coming together of atoms—and "at that moment, the finger of God was first laid upon my forehead." Millions of Americans, at the moment they see an intricately made unborn child sucking his thumb, may hear not a great and powerful wind nor an earthquake, but a gentle whisper.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Wealth of Naciones

People Power Comes to Latin America

David Asman

Fifty years before Alexis de Tocqueville wrote *Democracy in America*, another foreign reporter toured the United States, recording the characteristics of the land and its people. Born in 1750 in Venezuela, Francisco de Miranda was one of Latin America's first and most swashbuckling revolutionaries and a leader in his country's independence movement. Fleeing Spanish authorities in 1783, he spent a year touring the new North American republic. His detailed and insightful notes help us understand why the post-colonial period of these two regions turned out so very differently.

Miranda was enamored with life in the United States, not because of its richness in comparison to Latin America, but for precisely the opposite reason: despite a generally poor and even hostile environment, free citizens were creating wealth everywhere and in every way. In New England, he noted:

> The soil seems poor and is poor. Farming consists mostly of pasture grazing, corn, and rye. But such is the industrious spirit with which freedom fills these people that a small plot of land allows them to feed their large families, pay heavy taxes, and live well and pleasantly, a thousand times happier than the slave-owning landlords of rich mines and fertile lands in Mexico, Peru, Buenos Aires, Caracas, and all the Spanish American world.

Miranda was on to the mystery that continues to haunt observers of Latin American culture: What has prevented the region from creating lasting wealth out of the riches with which it is blessed? Miranda explained why through an anecdote that took place in New York during the Revolution:

> A farmer who owned the land on which Rochambeau's troops were encamped asked for his rent. The French officers paid no attention to this "absurd claim." Seeing this, the republican clodhopper cut short any further discussion and went off to fetch the Sheriff, asking him to arrest the trespasser. Your excellency should imagine the arrival of these two poor countrymen—the plaintiff and the Sheriff—unarmed but strong in support of the Law, and resolved to arrest the French General, M. de Rochambeau, in front of all his troops. The General was duly summoned by the Sheriff and required to pay all of his due....How, in such a country, could desert land fail to bloom; how could the shiest and most timorous of men fail to turn honest, just, hard working, educated, and courageous.

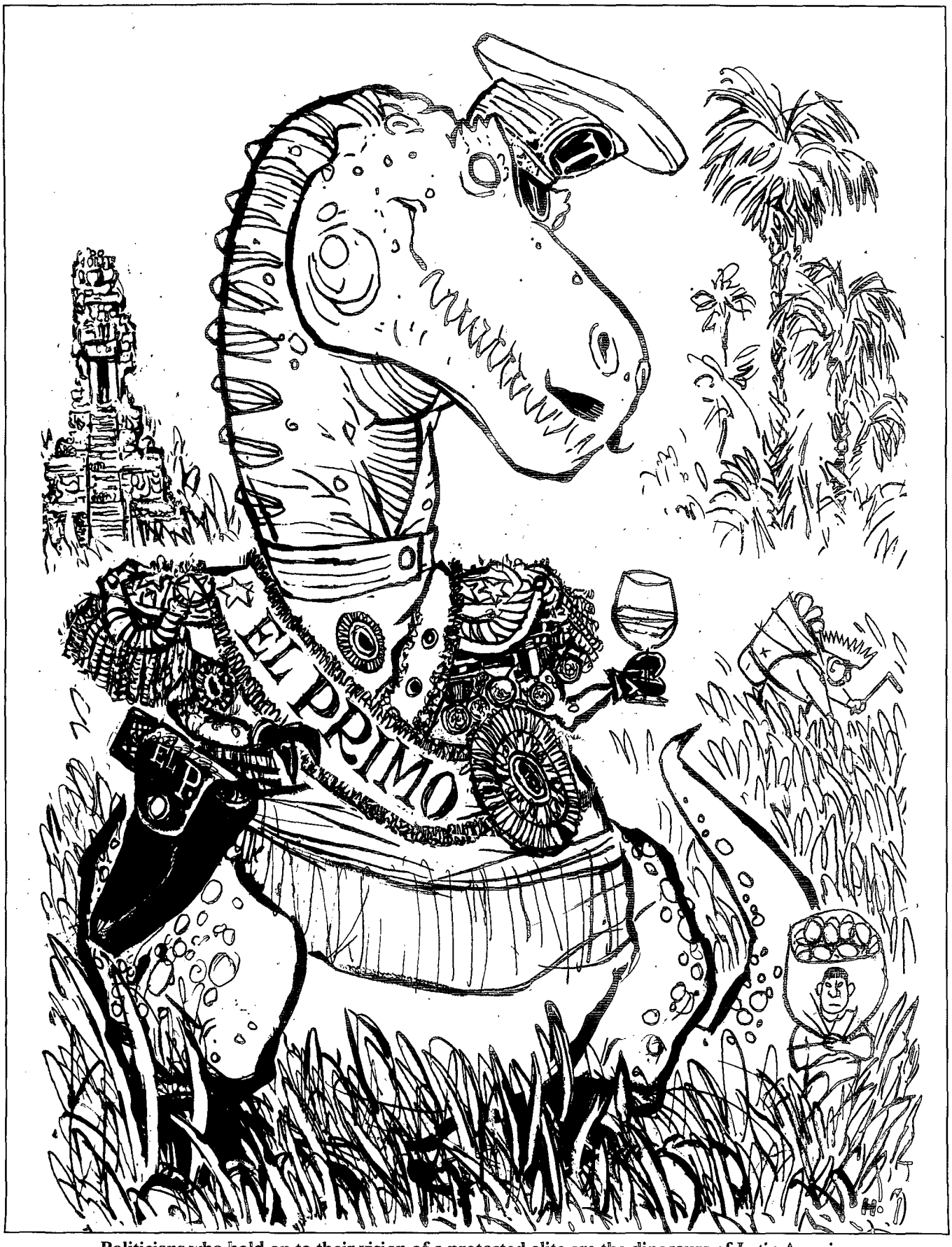
What captured the imagination of Miranda was a land in which the rule of law applied to all citizens equally. In fact, Miranda saw the absence of elitist privilege as the key element in our republic's ability to create wealth. And by contrast, he saw a rigid class structure, enforced by law, as the major obstacle to economic and social development in his own rich land.

Free-Market Boom

Just as privilege for the favored elite was the enemy of development in Latin America 200 years ago, so it is today. It's important to keep this in mind as we witness the current optimistic mood swing regarding the region. Yes, it's quite true that investment analysts from Tokyo to Wall Street now look to the region as one of the hottest growth areas in the world—and for good reason: The Mexican stock market has doubled in value annually for the past three years; Argentina seems poised to recapture its place as one of the world's wealthiest nations; a democratic, free-market Chile now provides investors with a guilt-free return on their investment. However, the extent to which countries like Chile, Mexico, and Argentina are experiencing an economic boom is in direct proportion to their leaders' success at breaking down the barriers that have coddled and protected their elite for centuries. Politicians in many other countries, Venezuela for example, are embarking on laudable privatization plans, balancing their budgets, and adhering to an International Monetary Fund restructuring plan as if it were gospel, without seriously opening up

David Asman *is an editorial writer for the* Wall Street Journal, *and editor of the newspaper's "Americas" column.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED



Politicians who hold on to their vision of a protected elite are the dinosaurs of Latin America.

Drawing by Alexander Hunter for *Policy Review*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

competition and opportunities for anyone but the favored elite. The prospects for social peace and sustained growth under such a program—witness the recent attempted Venezuelan coup—are poor.

But politicians who hold on to their vision of a protected elite are the dinosaurs of Latin America. A new generation of revolutionaries, inspired by the same ideals as Francisco de Miranda, have come into ascendancy. Their battle cry of liberty is sweeping the continent, and it has been taken up by an electorate whose voice can no longer be ignored in these new democracies. It is a social, political, and economic revolution of enormous dimensions.

The international political establishment—the U.S. State and Treasury Departments, the UN, the IMF and World Bank—maintained life-support systems for the Latin elite.

When I first began covering Latin America for the *Wall Street Journal*'s editorial page in 1983, there was little room to hope for or expect the kind of revolutionary changes we are now witnessing. Economically, the region was a basket case. Its leaders were unabashedly committed to statist policies of the worst kind. A year earlier, Mexican President Jose Lopez Portillo's expropriation of his nation's banking system not only disrupted Mexico's economy, but signaled to international investors that their profits and operating funds were not safe in Latin banks. The external debt crisis that followed seemed to drive the final nail in the coffin of Latin America as an investment opportunity. One country after another began to default on interest payments and some, like Peru under Alan Garcia, began to take seriously Fidel Castro's admonitions to snub creditors entirely.

Politically, the region was beginning to move to democracy, but ordinary citizens did not yet have much real choice in selecting their governments. Mexico's dominant ruling party, the Institutional Revolutionary Party (PRI), was throwing a few scraps and bones to the opposition, but such "favors" were parceled out with such imperial discretion that one could hardly refer to Mexico as a functioning democracy. Most of Central America was aflame, threatened by the ultimate elitist system: a Communist hegemony spread by the subversive influence of Cuba.

South America offered a slightly more hopeful picture. The election of President Raul Alfonsin in Argentina in 1983 marked an end to the cursed alternation between a caudillo-like Peronist presidency and brutal military rule. During the mid-1980s most of the remaining South American dictatorships were forced, by their own record of economic mismanagement, to yield to the ballot box.

Only Chile, however, pursued a truly open economic policy during this period, ironically under the watchful eye of a military dictator. For much of the decade, most of the other Latin American countries were still mired in policies of statist protectionism, which benefit only powerful vested interests. Those interests include a relatively small group of industrialists, protected from external competition by high tariffs and from internal competition by a fiscal and regulatory maze through which only the well connected can traverse; government-approved union leaders, pacified with labor codes that prevent any movement or negotiation on the part of individuals or independent unions; and, of course, the government bureaucrats, professional politicians, and military leaders, who make and change laws arbitrarily to suit their immediate needs or those of the other protected sectors.

In such a setting, the overwhelming majority of the people are left to pay the price—both as captive consumers and restricted workers—for the privileges of the few. The most important avenue of upward mobility is closed, as owners of small businesses are stifled by regulatory red tape and denied credit, export and import licenses, and, frequently, permission to enter many industries. Entrepreneurs without political connections have to operate outside the law, if at all; and they therefore operate without the property rights and court-enforced contractual protections that have led to the flourishing of small business in North America, Europe, and East Asia.

Master and Slave

So while the political nature of South America was becoming more democratic, the economies of these countries remained as backward as ever. But misguided economic policies, per se, were not at the root of the problem. At fault was a social attitude, as Francisco de Miranda had so clearly pointed out 200 years earlier.

In 1985 I had dinner in the Dominican Republic with the son of a wealthy construction engineer. Manuel had been educated in the United States, spoke English with an American accent, and had waited on tables in the U.S. while working his way through college. He was a self-effacing young man with an affable nature. But when the waiter came over—a man who was humble to the point of embarrassment—Manuel seemed to change character, becoming the Latin *padrone;* there was an immediate master-slave attitude apparent in Manuel's treatment of the waiter.

When the waiter left, I reminded Manuel that in the United States waiters often come from social backgrounds equal to or even above that of the people on whom they wait. I asked him if he thought the time would ever come when there would be that kind of social mobility in Latin America. Manuel did not hesitate a second. "Absolutely not! In Latin America, if your father is a waiter, you'll be a waiter—if you are lucky."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

I told Manuel that until this changed, Latin America would remain underdeveloped. An economy can only develop if individuals are free to explore their potential in different areas. When they discover that position that suits them best, they will perform to their maximum. With little social and economic mobility, a society is assured of stagnation. Manuel looked at me with his mouth agape. Surely an editorialist with the *Wall Street Journal* could not be so "egalitarian." And besides, he assured me, many capitalist enterprises from the States had adapted to the Latin way of doing things without losing their ability to build capital.

Up to a point, Manuel was right. Many of the inefficient, protected interests of Latin America came to rely on constant infusions of capital from the United States. But as Manuel had adapted to U.S. egalitarian standards while studying in the United States, so too had U.S. executives adapted to elitist Latin standards while operating in the region. For decades, foreign investors accepted the statist rules of the game because they were assured a protected niche in Latin markets, even if they did have to pay enormous "fees" to maintain that protection. These fees included contracts for political favorites, jobs for union-approved workers, sometimes even payoffs to Communist guerrillas to prevent kidnappings or sabotage.

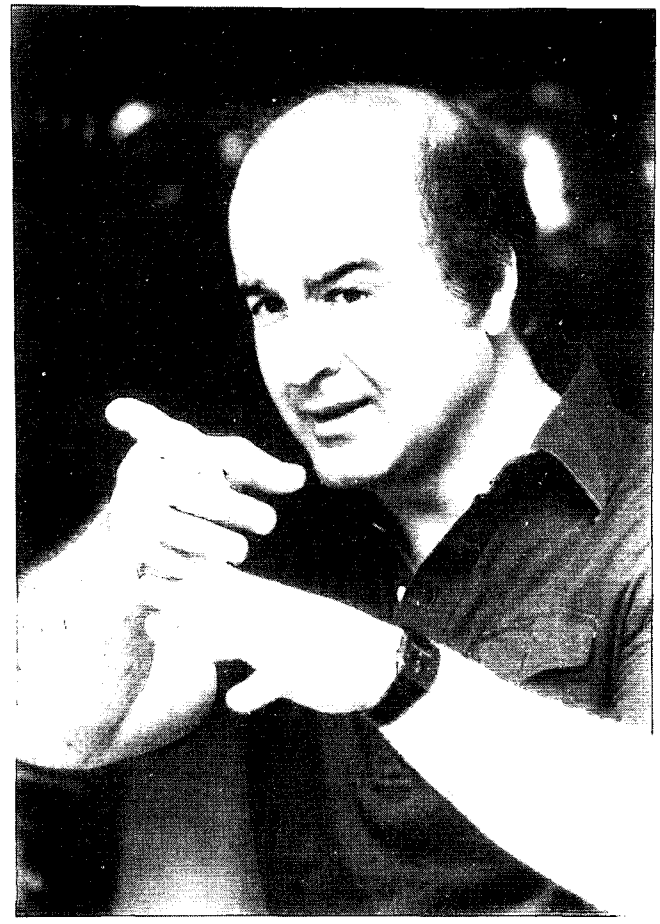
Pleasures of Monopoly

The ease with which deals could be made under these monopolistic conditions actually appealed to many foreign investors. A lawyer I know who had been involved in many large mining deals in Chile and Peru told me he could fly down to Santiago for a deal, sign one document with the head of a particular industry, and then spend the rest of the day at the Club de Golf. He could be back in New York in two days. "Imagine," he asked me, "how many different interests—not to mention lawyers—would be involved in a deal like that in the States?" Ironically, this lawyer prided himself on his defense of the free market and saw no conflict between his beliefs and his actions in Latin America.

To make such dealings palatable to U.S. observers, Latin business partners were brought to the United States and feted as pillars of Latin America's private sector. In fact, both sides were well aware that few of these "private sector" representatives operated in a genuinely competitive environment; most operated hand-in-glove with their friends or relatives in government who assured them of the protection they needed to survive.

In the case of loans, most U.S. private banks did not even make a pretense of seeking a "private sector" for their loan portfolios. Lenders such as Manufacturers Hanover typically made 80 percent of their loans in the region to public-sector projects, and the 20 percent going to the private sector were mostly to businesses protected by tariff walls or other government benefits.

Foreign investors began to shy away from this cozy arrangement with the Latin elite because it was a zero-sum game; with no wealth creation, the riches divided by the special interests (both foreign and domestic) began to dry up. But let history record: Only when their assets were seized in nationalizations and when debts went unpaid did these huge multinationals begin to seriously complain about government intrusion in the marketplace.



Carlos Bendezu

Peru's Hernando de Soto uncovered the vast untapped potential of Latin America's extraordinarily versatile underground economy.

Multilateral Rogues' Gallery

Besides the private economic transfusions needed to pump life into the anemic corporatist-statist enterprises, the international political establishment also maintained life-support systems for the Latin elite. The list of rogues in this category would include representatives from the U.S. State and Treasury Departments, the United Nations, and multilateral lending organizations such as the International Monetary Fund and the World Bank. These institutions backed the elite diplomatically and generally acted as primers for U.S. private investment when long-term loans were needed. For the better part of four decades, the advice proffered by these "experts" almost invariably ended up empowering the elite class further. (In fact, very often this advice came from the Latin elites themselves, who either acted as advisers for the U.S. institutions or were themselves put in charge of the multilateral funds.)

The ideological mindset of these international bureaucrats was rooted in a distrust of ordinary people; Latin Americans were considered too unsophisticated to cope with the value of currency, development of in-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

dustries, and allocation of their nations' riches. In Miranda's words, the "clodhoppers" of Latin America were viewed with deep-seated contempt by these world-caretakers. Thus, alongside the long-term mega-loans provided for gargantuan white elephants (such as inefficient cement factories or dam projects), economic policies were developed to make sure that the market would do as it was told. By whom? Why, by those who knew better.

The late Argentine economist Raul Prebisch was in many ways the godfather of such thinking. Working with the United Nation's Economic Commission on Latin America (ECLA), he and his aides devised policies that, unintentionally perhaps, kept the elite in control, practically insuring that this region would remain in a state of underdevelopment. A classic example was his promotion of "import substitution," for years advocated by IMF and U.S. Agency for International Development (AID) technicians. The idea was to "protect" emerging industries by creating barriers to imports. All this did was lead to the emergence of an industrial elite that hid behind barriers to avoid real competition. As a result, these protected producers churned out inferior products at inflated prices. Trade statistics looked great. But local consumers and truly competitive producers were held hostage to protected interests, and the economies of these nations stagnated.

Miranda's warning: a rigid class structure, enforced by law, was the major obstacle to economic and social development.

Siphoning Off Aid

Direct U.S. aid to Latin America also contributed to stagnation in the region. John F. Kennedy's Alliance for Progress reinforced the economics of privilege in Latin America. Reagan and Bush policies have really been no better. U.S. taxpayers may well wonder why billions of their hard-earned dollars funneled into Central America and the Caribbean (over $4 billion to El Salvador alone) coincided with significant *drops* in the region's living standards. The answer is directly related to the fact that the only group in these areas whose standard of living increased during the '80s were the protected elites who found ways to direct aid to themselves or through institutions that they controlled.

Of course, many of the projects initiated by AID teams were simply socialist cut-out schemes, such as the disastrous plan to nationalize El Salvador's banks and land tenure system. The elite group that benefitted from that policy were the corrupt politicians, and their business and union cronies, who siphoned off hundreds of millions of dollars during the administration of the late Napoleon Duarte. The Salvadoran military became the largest economic enterprise in the country. Meanwhile, the majority of Salvadorans were devastated, and the country's economy sank to levels not seen in decades.

This happened all over Central America and the Caribbean. Even so-called micro-enterprise projects meant to stimulate small-scale entrepreneurs eventually ended up in the hands of private interests who maintained government contacts. Departing from privatization trends all over the world, the Honduran military, flush with cash from U.S. Contra operations, bought a cement factory. In the Dominican Republic, AID economists set up an agricultural "price-support" program called Inespre. This program became a monster that eventually absorbed one-third of the Republic's federal budget. Besides completely distorting market mechanisms in that poor country, corruption flourished in Inespre; food products were illegally sold on the black market and one of its chiefs fled the country after pocketing millions of dollars.

Voices of the Market

The market revolution against this world of corruption and class rigidity was ignited by a remarkable movement of intellectuals. The region was blessed with extraordinary thinkers who shared a deep commitment to liberty and a healthy contempt for the various forms of elitist privilege that retarded growth and stifled the creative potential of their fellow citizens.

From Peru, Hernando de Soto wrote brilliant descriptions of the vast untapped potential of Latin America's extraordinarily versatile underground economy. Manuel Ayau from Guatemala and Jaime Darenblum from Costa Rica described how foreign aid had coddled and corrupted Central America's private sector. Mexicans Sergio Sarmiento and Alejandro Junco bravely reported on the inefficient and often corrupt nature of the ruling PRI, advocating an end to the protection of Mexico's political and economic elite. The late Venezuelan philosopher, Carlos Rangel—the man who first introduced me to the works of Francisco de Miranda—offered his penetrating descriptions of Latin character. Eduardo Helguera documented the absurd wastefulness of Argentina's statist enterprises, and successfully predicted the implosion of that nation's bureaucratic elite.

Slowly but steadily these voices began to be heard. Still, for their radical ideas to be translated into policy would take a special catalyst—something that would force Latin Americans to take on an elite that, in some cases, had not really been challenged for centuries. Perhaps even more formidable, the radical policies of these new revolutionaries directly threatened the positions taken by the international paymasters at the IMF, the World Bank, and the U.S. State Department. Ideas are powerful. But could they possibly be powerful enough to challenge conventional wisdom?

Hooray for the Debt Crisis

What broke the lifeline between the Latin elite and their economic and political protectors was the 1980s

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

debt crisis combined with the pressures placed on Latin politicians by an increasingly democratic environment. The debt crisis, indeed, may have been the best thing that ever happened to Latin America. The spigots had been turned off for a system that was making the Latin elite rich, but denying opportunity to the majority of the population. Latin governments could no longer rely on foreign riches to keep their economies running. The only place the elite in Latin America had to turn for growth was to its own people.

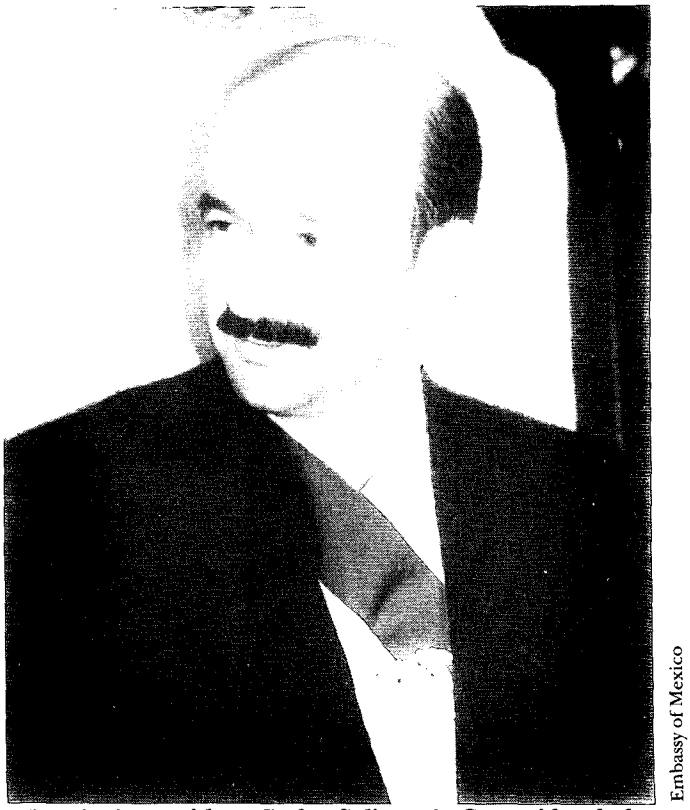
Latin politicians realized that if they were to survive in the new, more democratic environment, they had to devise methods of wealth creation from the inside. In September 1988 I took a plane trip with Raul Salinas, older brother of President Carlos Salinas de Gortari. Not only was Raul Salinas completely familiar with Hernando de Soto's revolutionary book on the underground economy, *The Other Path*, he was already looking for ways to draw Mexico's underground economy above ground. At that moment I realized that, despite positive movements in the right direction during the previous administration of President Miguel de la Madrid, the administration of Salinas (who at that time was still the president-elect) would represent a quantum leap in reversing the conventional wisdom regarding development in Latin America.

Indeed, it's a wonderful historical paradox that the country that led the way in discouraging investment in Latin America—Mexico—also became responsible for reviving an interest in Latin America as a region of opportunity. In 1986, Mexico, facing rising inflation and an horrendous recession, joined the nations associated with the General Agreement on Tariffs and Trade (GATT). This signaled the beginning of the end of the old protectionist vision of economic development and the beginning of Mexico's attempt to join an ever-expanding global economy. Chile had, of course, begun its own revolutionary economic openings in the 1970s. But because Chile was ruled by a right-wing dictator, its economic successes were invariably written off by other Latin leaders as the result of strong-arm tactics against Chilean unions or the like. Mexico, with all its dictatorial blemishes, had greater legitimacy in the Latin democratic community. Its policies could not be easily ignored.

Salinas's Revolution

The market revolution, which started under President de la Madrid (1982–1988), and accelerated under President Salinas, led to an important expansion of the Mexican economy and a dramatic lowering of inflation rates. This was achieved because President Salinas and his economic team, headed by Finance Minister Pedro Aspe, were willing to take on economists from the IMF and elsewhere, who focused more on balancing the books than on producing economic growth.

In fairness to the IMF and other multilateral institutions, by the late 1980s they had renounced many of the interventionist policies that they once advocated. Their support for freer trade and privatization has been critical in helping Latin nations restructure their economies in the difficult transition to more open markets. Even Enrique Iglesias, head of the InterAmerican Development Bank and a former protegé of Raul Prebisch, now publicly refutes import substitution as a failed economic model.



Embassy of Mexico

Mexico's President Carlos Salinas de Gortari has led the way in opening opportunity for those outside the politically favored.

Nevertheless, the IMF continues to advocate policies that often place the blame for inflation and other economic ills on forces in the market—rather than on government bureaucrats interfering in the market. For example, they still adhere to the notion of reducing inflation by suppressing demand. Economic growth might lead to an "overheated" economy, which in turn would lead to more inflation. So methods for suppressing demand—as well as a CPA-like commitment to balancing the books—are advocated. These policy recommendations vary according to circumstances, but they often include the addition of new taxes (usually VATs) and currency devaluations. Of course, while tax increases might temporarily make fiscal statistics look better, they do so by lowering the overall GNP because they discourage growth. And although devaluations may make trade statistics look terrific because exports become very cheap for foreign buyers, devaluations also have the pernicious effect of wiping out savings and further reducing citizens' purchasing power. In other words, a few exporters might get rich, but the common people, who must rely on savings to survive or start their own enterprises, are crippled.

In 1988, President Salinas argued that one could also reduce inflation by increasing supply. He had seen the success of this supply-side model in the United States, where President Reagan dramatically lowered regulations and tax rates, initiating a 33-percent increase in the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

U.S. GNP over eight years. Of course, inflation during this historical period of growth did what only a handful of supply-side economists said it would do: it came down dramatically. In short order, the same thing that happened with the U.S. supply-side revolution began to happen in Mexico. Real growth took off and inflation plummeted after Mexico slashed marginal tax rates (down to a 35-percent top rate from 60 percent), deregulated capital markets, tore down barriers to trade and investment, and slowed currency devaluations to a virtual parity with the U.S. dollar. "Has the IMF learned from the Mexican success story?" I asked Aspe last December. He shook his head and smiled. "Some things never change," he answered.

Argentina Fights the IMF

If the IMF did not sufficiently credit Mexico's supply-side success story, other Latin leaders did. In January 1991, Domingo Cavallo, who had studied with Carlos Salinas and Pedro Aspe at Harvard and MIT 15 years earlier, was appointed Argentina's new finance minister by President Carlos Menem. Cavallo had remained friends with Aspe and he was well aware of the Mexicans' problems with the IMF over supply-side growth policies. But Cavallo is a man with a vision. "The room for increasing the supply side of the Argentine economy is incredible," he told me last July. In defiance of the IMF, Cavallo enacted a comprehensive program last spring based on price stability and growth. His proposed supply-side tax cuts were even more dramatic than those enacted in Mexico, and the IMF put up a fight. "They didn't believe we could increase revenue by cutting rates," he said. In order to receive partial payment of an IMF stand-by loan, Cavallo was forced to give a bit. But on one point, Cavallo would not yield: his plan enacted in April 1991 to fix the Argentine currency to the dollar.

U.S. taxpayers may wonder why the billions funneled into Central America and the Caribbean coincided with significant *drops* in the region's living standards.

Cavallo's convictions on this point run deep. He recently stated that currency is to an economy as language is to a culture. Without a language whose meaning is clear, well defined, and unchangeable, a culture cannot retain its past achievements or pass on those achievements to future generations. Likewise, an economy cannot function properly without a currency that investors and consumers can count on as maintaining its value. Earners must have confidence in its value if they are to save, and investors must have confidence in its future value if they are to invest in growth bonds.

In addition to lowering internal tax rates and anchoring the currency, the Mexican and Argentine reformers opened their economies to greater foreign competition. Mexican trade barriers, which had averaged above 40 percent, were lowered to their current weighted average of less than 10 percent. Argentina's top tariff rate was lowered to 20 percent, down from levels far exceeding 100 percent. No more would local industries have to waste time and energy avoiding taxes and trade barriers to smuggle in the equipment they needed to compete on world markets. On these measures, Cavallo and Aspe received no arguments from IMF economists.

Consumers are perhaps the most obvious beneficiaries of the new open borders. In addition to keeping prices low, open trade borders allow consumers to choose quality merchandise from around the globe, something that previously had been reserved only for those rich enough to afford smuggled merchandise or shopping trips to Miami. Local producers in an open economy also have to match international quality standards to remain competitive, so consumers benefit from better-made local items as well.

Another set of benefits has come from the deregulation of banks and capital markets. Mexican families who once had to purchase houses with cash now have access to home mortgages as well as consumer loans. Small businesses no longer have to be politically favored to get credit or foreign currency.

Reducing Corruption

All these benefits have created a political consensus for open markets among the majority of the people. Before markets are open, consumers generally don't know what they are missing and the rhetoric of political populists arguing for "protection of sovereign interests" wins elections. However, these arguments ring hollow once consumers become part of the global economy. This is most clearly demonstrable in Chile, where the once interventionist President Patricio Aylwin recently lowered the tariffs from 15 percent to 11 percent with the full support of both consumers and producers. And today in Mexico, where just a few years ago the nationalist arguments held sway, 80 percent of the people favor a further opening of the economy through a free-trade agreement with the United States and Canada.

There is also a sociological effect of this openness as concerns local corruption. Despite prejudices to the contrary, the source of corruption in any society is not to be found in the blood of the people. Latins are no more prone to corruption than Orientals or gringos. Corruption is primarily found in a marketplace that is protected from competition. Only by offering bribes to the single supplier is it possible to obtain the quality of merchandise desired, whether a public service or a product. However, if the supplier of a product is forced to compete for customers, he must supply the best quality and the cheapest price to assure sales.

The opening of markets causes some pain, of course. There will be a difficult period of adjustment in Mexico and Argentina, as there was in Chile, as entrepreneurs

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

are stripped of their protection and forced to compete on world markets. And not all formerly protected businessmen will adapt to the new openness. However, as with the formerly protected industrialists from Chile, the entrepreneurs in Mexico and Argentina have been finding that the advantages of joining the global economy are far greater than remaining behind their isolated pillars of protectionism.

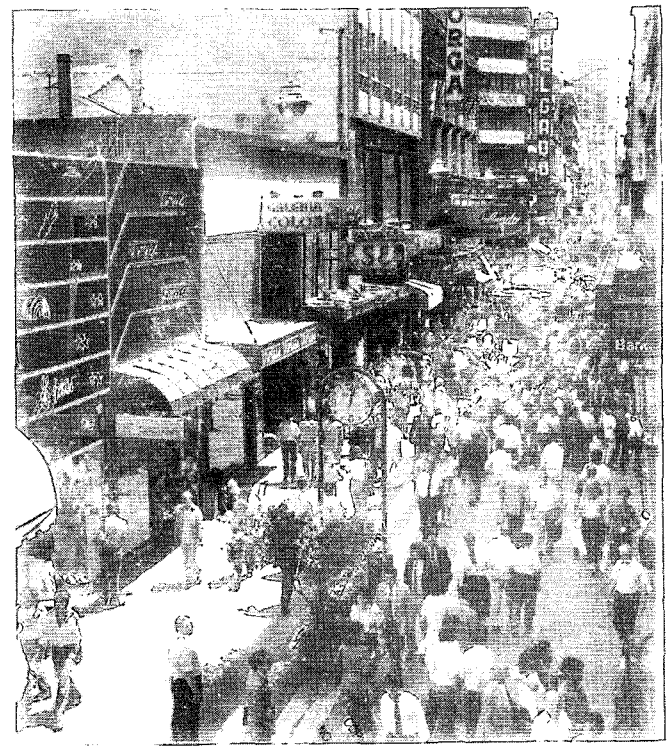
Dangers on the Horizon

This new style of Latin American entrepreneurship has been perhaps the most notable change in recent years. Even in still-protected countries like Brazil, a new generation of entrepreneurs long to see their country become an active member of the global economy. In making their case for an open economy, these new global entrepreneurs have the psychological advantage of being on the side of a great historical wave: practically the whole world is now abandoning interventionist economic models.

The success of the Mexican, Argentine, and Chilean models—and the added benefit of a possible hemisphere-wide free-trade agreement with the United States and Canada—has spurred the imagination of entrepreneurs and investors the world over. But investors in the Latin market are generally far more sophisticated now than they were in the heady years of the late 1970s and early 1980s. Today's investment banks are staffed with economists who look beyond the raw statistics. They recognize that business ventures do not exist in a vacuum. They look at whether the incentives for growth exist in the country in which they may be investing. It is not enough for finance ministers to announce a renegotiation with the IMF, or to mouth nice words about the free market. If today's more sophisticated investors see interventionist economic policies depleting the energies of the country's most important asset—the creative and productive energies of the work force—most will simply shift their resources elsewhere.

Policies favored by development experts were rooted in a distrust of ordinary people.

What most concerns these investors now is whether the dramatic changes in the economic and social structure of Latin America will be permanent, or just another passing fancy to be discarded by the next generation of elites. There is a worrisome trend in Latin America's new democracies to institute changes by presidential edict; the rule of man still governs instead of the rule of law. The Chilean government there is beginning to parcel out concessionary grants to "preferred" investors. In Argentina, President Menem has stacked the Supreme Court (by getting the congress to increase the number of jurists to nine from five), and is sending many of his most favored bills directly to *his* court. And in Mexico, too many deregulatory measures have been instituted through the almost imperial force that presidential power represents there. These are vestiges of the dictatorial past, and they play right into the hands of those who want to regain their lost privileges.



Archive Photos

Bustling Buenos Aires. Says finance minister Domingo Cavallo: "The room for increasing the supply side of the Argentine economy is incredible."

Nevertheless, the momentum is on the side of the reformers. Advocates of freedom are becoming policymakers. And once in power, they outweigh the former privileged classes many-fold because they have the collective energies of their nation's aspiring producers behind them. If they do win the battle for control of Latin America's political, economic, and social realms, the possibility of Latin America becoming a land of opportunity will be no more remote than it was for the barren land on which Francisco de Miranda learned that wealth can only be created where men are free.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Trenton Tea Party

The Story of New Jersey's Tax Revolt

David Kehler

Not since George Washington crossed the Delaware and routed the surprised Hessian mercenaries in Trenton has there been such an astonishing reversal in New Jersey as the elections of 1991. Little more than a year before, the Garden State's Democratic governor Jim Florio had been the rising star of American liberalism, a candidate Mario Cuomo was pushing for president. But last November, Florio was sharply rebuked as the Republican Party rode the wave of an angry tax revolt and pulled off a stunning landslide victory, ousting scores of Democratic county and municipal officers and winning veto-proof majorities in a senate and assembly that had both been in Democratic hands.

During the 1989 governor's race, New Jersey voters had warmed to Florio's plucky story: a high-school dropout who got his diploma in the Navy, he worked his way through college, earned a law degree, toppled the notorious Camden Democratic political machine, and won a seat in Congress where he was a leader in environmental legislation. In the gubernatorial campaign to succeed popular Republican Tom Kean, Florio promised to cut auto insurance rates, said that he saw "no need" for a tax increase, and added that he would conduct an operational audit of state government prior to hiking any taxes. He easily defeated his fellow U.S. congressman, Republican Jim Courter.

Off Like a Rocket

Installed in January 1990, the Florio administration took off like a rocket. Rarely has a new governor led fundamental changes in so many key policy areas in his first six months. As promised, he forced auto insurers to rescind their surcharge on premiums. Then he banned semi-automatic firearms. These two initiatives were emblematic of the new governor's style: definite policy proposals, a push for quick legislative action on those proposals, a recognition that the policy changes would cause controversy, and then not a twinge of intimidation when criticized. Florio didn't back down when auto insurers left the state rather than comply with the new regulations, or when gun owners launched a noisy demonstration in front of the state house. He was soon attracting national attention as a tough-minded liberal, a man with a mission and a keen appreciation of the power of his office.

Meanwhile, as in many other states, the chickens were coming home to roost for the extravagant spending commitments of the 1980s. The Garden State's rapid growth in expenditures had been fueled by plentiful revenue streams that were now drying up. As Florio took office, he announced that state finances were worse than he realized—a $600-million deficit loomed in the fiscal year 1990 spending plan of $12 billion, Governor Kean's final budget, which had originally balanced with some creative accounting: overly optimistic revenue estimates, gimmicks, and the use of surplus funds.

Florio's Bombshell

Florio's response came in March 1990, and it was a bombshell. He called for spending freezes and deferrals to plug the 1990 budget gap (the fiscal year would close on June 30), and he proposed a FY1991 budget that would hold spending at the FY1990 level. And then, in perceived contradiction to his campaign promises, he called for $2.8 billion in tax increases. Liberals around the country saluted him for his daring, for having the courage to raise revenues to forestall major program cuts. Instead his action revealed the limits to public tolerance of taxation, as he and his fellow Democrats quickly incurred the wrath of New Jersey voters.

Florio's tax proposals were of two parts. $1.5 billion of the new revenue would come from an increase of the sales-tax rate from 6 percent to 7 percent, a broadening of the scope of purchases subject to the sales tax, and excise-tax increases. These proceeds were to replace the roughly $1 billion of surplus and nonrecurring revenue resources used to balance the FY1990 budget and to fund the expenditures deferred from that budget year to FY1991. The other $1.3 billion would come from a personal income-tax hike on singles with incomes over $35,000 and couples making over $70,000. This revenue was targeted for a new system of school finance, state government takeover of some court and social-services

David Kehler *is president of the Public Affairs Research Institute of New Jersey.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

AP/Wide World Photos

New Jersey voters reacted ferociously to Governor Florio's $2.8 billion tax increase.

costs previously borne by county and municipal governments, and a new system of payments to home-owners and renters to help offset their property-tax burdens, all beginning in FY1992.

The school aid plan was the governor's response to prolonged litigation over public education funding. New Jersey has over 600 school districts, many of them tiny, and a funding scheme heavily reliant on property taxation, so there were great differences between districts in expenditures per pupil. The state supreme court, in 1990, ruled that New Jersey had to equalize expenditures for a specified group of 28 low-spending districts to a level equal to the average spent by a specified group of high-spending districts. Florio's proposal went much further, increasing state aid to over 300 poorer districts and lowering it for about 200 wealthier districts. One element of the plan transferred teacher pension costs from the state government to local districts. This enraged the state's major teachers' organization to such an extent that the union endorsed almost exclusively Republican candidates in the 1991 legislative election. (The pension transfer was later postponed for two years.)

The Florio budget and school proposals blitzed through the legislature, just as the auto insurance and assault weapons measures had. Hearings were perfunctory. A time limit was imposed in one house of the legislature to truncate debate on the tax bills. The proposals passed with little amendment but solid Republican opposition.

New Jerseyans were stunned by the governor's tax proposal. The amount was staggering: $2.8 billion, when the whole budget was only $12 billion. Taxpayers began to question why the government wasn't being scaled down. After all, hadn't New Jersey state government spending more than doubled in the previous decade, growing faster than personal income, the inflation rate, or any similar yardstick? Where was the audit that candidate Florio had promised he would undertake before raising taxes? The school-funding scheme added to the controversy. Many New Jerseyans resisted the notion of paying higher income taxes to finance increased aid to urban school districts that they regarded as inefficient and, in some cases, corrupt.

Streaming Toilet Paper

Talk radio turned private unhappiness into public tax revolt. A new megawatt FM radio station, billing itself as New Jersey 101.5, was attracting an adult audience with a catchy format of oldies rock and listener call-ins. The hosts of the afternoon time slot, John Kobylt and Ken Chiampou, savaged the Florio tax proposals, the Democratic legislators, and politicians in general. Soon the John & Ken show attracted a wide audience—on the beach, over the sound systems of small retail stores, and on afternoon commutes.

One day in June, shortly after passage of the Florio tax plan, a postal worker named John Budzash called John & Ken to complain about it. The talk show hosts suggested that he organize a protest against the tax increases. Budzash accepted the challenge and started an organization, Hands Across New Jersey, dedicated to repealing the tax hikes. Within days, Hands organized a

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

protest rally at the state house that attracted about 5,000 people, and, within weeks, the organization claimed that it had close to a million signatures on a petition for repeal of the tax increases. Both were widely discussed on New Jersey 101.5, which added to its music mix a new song, "Florio Has Got to Go."

The articulate, energetic Budzash phoned John and Ken frequently to reach his constituency. Smaller protest groups were also formed, with names like Tax Revolt North. Anti-Florio and anti-tax bumper stickers were seen in profusion on New Jersey autos. Toilet paper, again subject to the sales tax, streamed from the car radio antennas of protesters at rallies.

Although Republican leaders quickly embraced the tax revolt, Budzash was an equal-opportunity critic: he was quick to point to the Kean administration spending increases that had set the stage for the budget crisis.

The tax revolt revealed a powerful new political force in America: talk radio as a galvanizer of grass-roots action.

(Budzash later left Hands and the group splintered when some members tried to link efforts with Republican interests.) Democrats were taken aback by the profile of the protestors at the Hands rallies: middle-income and lower-middle-income people, exactly the folks who were expected to benefit from Florio's property-tax relief measures.

Then came a shocker: the near defeat of U.S. Senator Bill Bradley in the 1990 elections. Bradley had seemed a cinch to trounce his underfunded and little-known Republican opponent, Christine Todd Whitman. The senator refused to speak on the Florio tax plan, saying it was a state government question not germane to the federal office being contested. But citizens do not draw such fine distinctions between levels of government, and tens of thousands of voters regarded the Senate race as an opportunity to protest the tax hikes. Whitman almost toppled Bradley, garnering over 48 percent of the vote.

More Gimmicks

Something extraordinary was happening to New Jersey politics. A daily newspaper, the *Trentonian*, had begun to provide extremely caustic coverage of the governor and other officials. Some of the Democratic legislative leaders started to distance themselves from Florio.

In the face of this criticism, Florio had a coherent defense: the Kean administration's spending spree caused the budget problem; the national recession would force many other states to hike taxes, too; the audit (by then in progress) and other cost-control measures would rein in state government expenditures; and New Jersey's exceptional and rapidly increasing property-tax burden would be halted. These points were ignored or rejected by wide segments of the public, even though Florio was, in large measure, right on every count.

In February 1991, three months after the Senate election, the governor presented his FY1992 budget proposal. This time, no new taxes were included, but the plan contained measures to downsize the state government work force and to cut the growth of spending on employee health benefits. While the legislature would not approve Florio's benefits cutback proposal, an early retirement scheme was enacted, which, combined with some other measures, reduced the state government work force by about 5,000. The performance audit also had identified a number of cost-control opportunities, some of which began to be adopted.

The FY1992 budget had unappealing aspects. It was balanced, in part, through gimmicks such as the sale of a portion of an interstate highway to the New Jersey Turnpike Authority for $400 million. A change in utilities' tax payment schedules would later lead to rate increase requests. The budget passed.

In early 1991, though, the legislature, spurred by savvy Senate President John Lynch, a New Brunswick Democrat, revised the generally unpopular education funding act that had been adopted less than a year before and had not yet been put into effect. Some $360 million originally targeted for school districts was shifted to municipal governments to provide property tax relief. About a third of these funds were diverted from the 28 special-needs districts. Additionally, strict spending limits were imposed on school districts. Beyond this, Senator Lynch began to stump the state, denouncing bloated school bureaucracies, spendthrift boards of education, and greedy teachers' organizations. The education interests were furious, and the major teachers' organization made a special (ultimately unsuccessful) effort to target Lynch for defeat in November.

GOP Landslide

The Republican Party was brimming with confidence heading toward the November elections. The public was still irate about the 1990 tax increases, the $400 million road sale provided a new symbol of disturbing fiscal policy, and the Republican members of the legislature had provided solid opposition to the most controversial pieces of legislation. GOP legislative candidates conducted a unified campaign. Although the party developed a broad platform addressing many policy areas, the candidates focused their efforts on criticism of the governor and his tax program. The Republican platform promised a rollback of the sales-tax rate from 7 percent to 6 percent, but many candidates attacked the entire tax scheme. On election day, the Republicans won a crushing victory, toppling even a few Democrats who had voted against the tax measures.

Some Democratic incumbents, particularly in the Trenton area where many state government employees reside, were defeated for their association with the administration's employee benefits reduction proposal. The teachers' union also played an important role, as it

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

endorsed Republicans to punish Democrats for their actions on pensions and repeal of school aid. But the most important message of the election was the overwhelming voter disapproval of the tax increases.

Gaping Budget Hole

The challenge for Republicans was that they now had to come up with spending cuts to fulfill their campaign promises on taxes. John Lynch, still senate president in the lame-duck legislative session, put them on the defensive by proposing repeal of the entire $2.8-billion tax package—which would give the incoming Republican-controlled legislature a gaping hole in the budget to close. Republican legislators protested and, for a time, boycotted legislative meetings to prevent a quorum, saying that their platform only pledged to repeal the sales-tax rate increase, nothing more. Florio watched, surely with amusement at the Republicans' discomfort. Lynch's comprehensive tax-repeal proposal was approved by the senate, but assembly Democrats killed it, fearing complete repeal would require extraordinary spending cuts.

The new legislature took office in mid-January. One month later, Florio presented his FY1993 budget proposal. It included neither a tax hike nor a sales-tax reduction, but did reduce appropriations for public employee pensions due to a reasonable change in the valuation of pension fund assets. Medicaid, aid to school districts, and state government employee health benefits were all slated for major spending increases, but 14 of the 19 departments had their budgets cut. Republican legislators have pledged to reduce the sales-tax rate beginning in FY1993, and they will have to cut Florio's $15.7-billion spending proposal by $580 million to enact a balanced budget. As this article went to press in mid-March, the Republicans had not announced their proposed trims.

There are four areas where major cost savings should be possible. The cost of public employee health benefits has been skyrocketing, growing by 42 percent from FY1991 to Florio's FY1993 budget request. The growth of such costs could be lowered by maximizing enrollment in managed care programs.

Managed care is also a viable option for reducing Medicaid costs, as only a tiny fraction of New Jersey's Medicaid population is enrolled in HMOs. Beyond that, the Medicaid program could be scaled back on equity grounds. At almost 10 percent of total state government expenditures, the program provides a breadth of services for indigents far greater than those available in the health-care plans of many working New Jerseyans who are taxed to fund Medicaid. Some Medicaid services not involving life-threatening matters, such as dental care, could be suspended or eliminated.

With determinate sentencing, corrections has been one of the growth industries in New Jersey in recent years; Florio's budget recommends spending $643 million in FY1993 for this function. New Jersey has been a national leader in experimenting with electronic monitoring and house arrest with generally successful results. Expansion of this approach to the latter stages of confinement for more prisoners would provide cost savings and ease the transition from prison to freedom.

A fourth spending area requiring review is New Jersey's "homestead rebate" system of transfer payments to home-owners and renters to offset property-tax burdens. These expenditures might be diminished in tandem with the sales-tax rate cut.

Fiscal Liberalism's Last Hurrah

Several important lessons for American politics come out of the New Jersey elections. The first is confirmation of the basic concept of Reagan federalism: public pressure is more effective in checking government spending growth at the state level than at the federal level. Sharp program cutbacks have not yet occurred, but they are likely as the new legislature works to deliver the sales-tax rate cut. New Jersey is certainly practicing greater fiscal discipline today than is the federal government with its $400-billion deficit.

The ever-resourceful Florio may be beginning a new political career as a cost cutter.

Second, the ferocious reaction to the abruptness of the New Jersey tax increases showed policy-makers in other states what not to do. In 1990 Florio accurately predicted that there would be subsequent state tax increases in other parts of the country. However, when politicians elsewhere have called for higher taxes, they have appeared to do so reluctantly; they have communicated a sense of crisis requiring a tax increase as a "last resort."

Third, the New Jersey tax revolt, by focusing on the state government expenditure excesses of the 1980s, has made it easier for politicians to challenge formerly sacrosanct programs. For example, a comprehensive welfare reform package, sponsored by Wayne Bryant, a Democrat, was enacted in the waning days of the last legislature. It includes provisions requiring recipients to participate in education, training, or job-related activities as a condition of receiving benefits; prohibits grant increases for additional children for a woman already on welfare; and eliminates disincentives for welfare clients to marry.

Most important, the elections revealed the political limits to fiscal liberalism. Neither labor unions nor civil rights leaders nor environmentalists nor any other liberal groups made any special efforts to preserve the Democratic legislative majority last November. No one in New Jersey seriously proposes new spending initiatives. And the ever-resourceful Governor Florio, so derided by tax protesters, may be beginning a new political career as a cost cutter. Tax-and-spend liberalism may have seen its last hurrah.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Fighting Trim

How to Cut the Defense Budget by $100 Billion

A Symposium

Over the next several years, Congress is likely to cut the annual military budget by at least $100 billion. In making these cuts, Congress will be strongly tempted to focus on protecting its pork-barrel interests and the bureaucratic interests of the services.

In the hopes of focusing the defense-downsizing debate where it belongs—on the defense programs most needed in a time of constrained budgets—*Policy Review* stipulated an annual military budget for fiscal year 1997 of $100 billion less than today's and asked six military experts to address three questions. 1) What are the most important security threats the U.S. is likely to face five to 15 years from now? 2) To guard against these threats, what missions must U.S. armed forces be prepared to carry out, and what kinds of weapons, forces, and deployments will be required? 3) To guarantee resources for these priorities, how would you cut existing military expenditures by $100 billion annually?

Ted Galen Carpenter

For the first time in more than 50 years we do not confront a powerful state, such as Nazi Germany or the Soviet Union, that could pose a grave threat to U.S. security. The absence of a would-be global hegemon should fundamentally alter U.S. defense policy. Although the post-Cold War world may well be a disorderly place, without a powerful rival to exploit the turmoil, most of the parochial conflicts and quarrels will be irrelevant to America's own security interests. The United States can afford to view them with detachment, intervening only as a balancer of last resort if a conflict cannot be contained by powers in the affected region.

The most serious potential threat to American security is the proliferation of nuclear weapons among the Irans, Libyas, and North Koreas of the world. As a result, Washington must be doubly cautious about intervening in regional disputes that do not have a clear and compelling relevance to America's security interests. The only thing worse than gratuitous meddling in such conflicts when the parties are armed with conventional weapons is doing so when one or more of the parties have nuclear weapons.

A second implication of proliferation is that the United States must maintain a credible strategic arsenal—2,000 to 2,500 weapons deployed on submarines and long-range bombers—as a deterrent. The proposal of Robert S. McNamara and others to reduce the U.S. arsenal to 1,000 warheads or fewer is impractical in a multipolar nuclear environment.

The dangers posed by proliferation also greatly increase the need for an effective shield against ballistic missiles. Indeed, the ABM program is one area for which the FY1993 military budget should be *increased* from the $5.4 billion proposed by the Bush administration.

Withdrawal from Europe and Asia

America's post-Cold War defense forces should be geared to neutralize threats to American security, not to intervene in regional conflicts or to protect Cold War-era allies that are now capable of defending themselves. This means concentrating resources on long-range retaliatory forces and strategic defenses. In addition to a "strategic dyad" of eight to 10 Trident missile submarines and a bomber fleet (50 to 60 B-1Bs or B-52s), the United States should maintain a 250-ship Navy (including six carrier battle groups) and 17 tactical air wings (10 Air Force, two Marine, and five Navy). Ground units—the least relevant arm of the military in a post-Cold War setting—should be pared to an active-duty force of 270,000.

Most important, over the next five years the United States should withdraw and demobilize the forces sta-

Ted Galen Carpenter *is director of foreign policy studies at the Cato Institute.* **Angelo Codevilla** *is senior research fellow at the Hoover Institution, Stanford University.* **Aaron Friedberg** *is assistant professor of politics and international relations at Princeton University.* **William R. Hawkins** *is director of economic security studies for the U.S. Business and Industrial Council in Knoxville, Tennessee.* **Murray Weidenbaum** *is director of the Center of the Study of American Business at Washington University in St. Louis and author of* Small Wars, Big Defense *(Oxford University Press, 1992).* **Dov S. Zakheim**, *a former deputy under secretary of defense, is CEO of SPC International, Arlington, Virginia, and adjunct scholar of The Heritage Foundation.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

tioned in Western Europe, Japan, and South Korea. With the disintegration of the Soviet Union, it is absurd to protect these nations from secondary threats that they should be able to handle with their own military resources. The Bush administration contemplates keeping 150,000 troops in Europe indefinitely—plus reinforcements stationed in the United States—at an annual cost to American taxpayers of more than $90 billion. Washington's security commitments in East Asia (primarily to Japan and South Korea) cost another $40 billion annually. Yet Japan has the world's second-largest economy and can easily afford to spend more on defense. South Korea has twice the population of and an economy 10 times as large as its only conceivable adversary, North Korea.

If the United States jettisons such obsolete alliances and adopts a force structure appropriate for the conditions of a post-Cold War world, it can protect the nation's security with an active-duty force of approximately 885,000 personnel at a cost (after a five-year transition period) of $125 billion a year (measured in FY1993 dollars). That sum is considerably less than the Bush administration's projected FY1997 budget of $237.5 billion (also in FY1993 dollars).

Even at $125 billion, the military budget of the United States would still be three to four times larger than the probable 1997 budget of any other member of the Group of Seven industrial powers. The cuts may seem radical in the context of the bloated Cold War-era budgets that have come to be considered "normal," but with the passing of the Cold War, we must change our ideas of what constitutes normal defense spending.

Angelo Codevilla

Because the American people have substantial interests everywhere, wars anywhere may involve us. Hence we should build our military for the long run: staying abreast of technology, remaining mindful of geographic requirements, maintaining the ability to build up rapidly to meet threats as they emerge, and keeping it all affordable.

The missions are straightforward: Protection against air and missile attack, control of the world's oceans, as well as the capacity unilaterally to crush a medium-sized rogue state or to be the backbone of a coalition against anyone. These missions should be entrusted to small active-duty forces, backed by very large reserves, superabundantly equipped with the latest weapons.

This is precisely the opposite of the plan that President Bush is endorsing: only a 25-percent reduction in the three services' active-duty personnel at the expense of the production of new weapons. If we follow this prescription, within a decade the equipment in the hands of our troops, much as in 1941, will contain a few experimental devices, while the rest will be obsolescent and the American defense industry will have lost the capacity to mass-produce quality weapons.

Dealing successfully with the missile threat is a prerequisite for military strength in the future. Soviet strategic forces have survived the death of Communism and are still poised for a disarming strike. The Soviet

AP/Wide World Photos

Bowing to Kim Il Sung. "The most serious potential threat is the proliferation of nuclear weapons among the Irans, Libyas, and North Koreas of the world."—Ted Galen Carpenter

military-industrial complex—aided by the Bush administration's mindless pursuit of arms control—is pressing Russia to act as if nuclear rivalry with America were natural, rather than something to be discarded along with Communism. Moreover, since the technology for producing missiles and warheads is spreading inexorably, we can expect that any of the world's dictators who wishes to shield his regime will do so by brandishing them.

To strike missiles before they are launched we need (as the Gulf War taught us) to rework our intelligence system to track mobile targets. The new devices should cost no more than those they replace. We should keep our Minutemen IIIs, MXs, and Trident D5s. We should retrofit them with equipment for on-line retargeting. This is far cheaper and more effective than the B-2 bomber, which was always a dumb idea. To defend against incoming missiles we need several thousand ground-based interceptors, a space-weapon component, and associated sensors. We are already spending some $4 billion per year in this field. If most of this $4 billion went for procurement instead of for marching in place, it should be enough. To this we should add a serious air-defense system whose forces are in a service of their own, the bulk of them active.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Savings from Payroll and Readiness

The Navy, Army, and Air Force missions should be performed overwhelmingly by reserves. Most of the ships, tanks, and planes in the inventory would sit in storage at operational locations—ready for use within weeks, but not requiring operational maintenance. A small percentage of the equipment would be in constant use by reservists performing their tours of duty. Most of the active-duty personnel would act as trainers to constantly "qualify" the reserves in the use of equipment, and as cadres to keep units ready to absorb the reserves' influx. If we build a high-quality reserve of four million people, we may safely reduce our active-duty forces to below 700,000 while enjoying the luxury of greater (although more latent) military power at much less cost.

The sea control mission will require some eight aircraft carrier battle groups—all based in the United States—of which no more than three would be operational at any given time. It will require perhaps 100 submarines, including the *Seawolf*, and an equal number of B-1 bombers configured to carry anti-ship cruise missiles. Only one-quarter should be operational. The amphibious fleet, roughly the present size, should have its active component dedicated to the ready intervention mission. The ready intervention force—one Army corps, one Marine division, 10 tactical air wings, a carrier battle group, as well as the necessary sea and air transportation—should be composed of approximately half the active forces.

The rest of the active forces should have as their main job husbanding the capacity of the United States to quickly man ground forces of 30 divisions, 60 tactical air wings, and everything that goes with them. Since their small number requires that they be primarily combat leaders, there should be no room in them for today's bloated research and development (R&D) and procurement bureaucracies. Those responsible for each mission should have the authority to purchase their own equipment from competing industry products.

"Asia, not Europe, is the probable cockpit of 21st-century great power rivalry."

—Aaron Friedberg

Where do we get the money? Today personnel and operations and maintenance (O&M) together cost more than twice as much as equipment. The essence of the Pentagon–Bush proposal is to rape procurement for the sake of personnel and O&M. But today it makes no sense to pay a lot of people to maintain readiness while sacrificing weapons that can win the wars of a decade hence. I suggest the opposite: cut military pay from about $82 billion to about $40 billion. Because active-duty forces would conduct fewer operations, cut O&M from about $85 billion to $35 billion, and leave procurement and R&D at about $80 billion and $30 billion, respectively. We should pay highly the few full-time, long-service cadre of officers and noncoms, pay enough to reserves to compensate them for loss of leisure time, and pay only subsistence to the junior personnel who fill out the active ranks for two years. That means reinstituting the draft—just like that paragon of military preparedness and fiscal soundness, Switzerland.

Aaron Friedberg

The United States is trying to distribute its dwindling defense resources among three objectives: preserving a substantial forward presence in Europe and Asia, sustaining the forces necessary to prevent attack directly on the United States, and maintaining the power projection capabilities needed to cope with the contingencies in the Third World. If the defense budget is to be cut by an additional $100 billion over the next five years, it will become extremely difficult to continue doing all of these things at once.

With the collapse of the Soviet Union the role of U.S. forces based overseas has shifted from deterrence to reassurance. By not withdrawing too quickly or too completely the United States hopes to convince its allies (especially Germany and Japan) of its continued commitment to their security and, in the process, to discourage them from dramatically increasing their own military capabilities. This is an important and worthwhile, but also a transitional, aim. As regional security agreements evolve, it should be possible to reduce the U.S. presence to a minimal, largely symbolic level. This is more likely to happen soon in Europe than in Asia. Indeed, despite the lengthy discussion among academics of the future stability of Europe, Asia is the far more probable cockpit of 21st-century great power rivalry. Relations among the major states (many of which have long and unresolved histories of mutual animosity and mistrust) are all in flux, economic and technological change are occurring at a rapid pace, and there exist none of the institutional mechanisms that have served over the past half-century to ameliorate relations between traditional European rivals.

If $100 billion in additional cuts are sought, a substantial fraction of U.S. forces in Europe (perhaps as many as 80 percent of the 150,000 troops that the Bush administration now intends to keep there) and a smaller portion of those in Asia (perhaps 20 percent of the planned garrison of 120,000) will have to be withdrawn and disbanded, along with supporting air and naval forces (especially those dedicated to ensuring sea control for purposes of transoceanic resupply). By some estimates, the Department of Defense now plans to continue spending as much as $80 billion on European land and sea defense and over $30 billion on Asia and the Pacific. Assuming for simplicity's sake that savings will be proportional to force cuts, reductions in forward presence along the lines suggested here would provide roughly 70 percent of the $100 billion required.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Emphasis on Cruise Missiles

Regarding the protection of U.S. territory: strategic nuclear offensive forces will continue to be necessary to deter potential attackers, albeit in significantly smaller numbers as the size of the former Soviet arsenal dwindles. Beyond proportional cuts already announced by the administration, another $10 billion to $20 billion could probably be squeezed out of strategic offensive forces without endangering deterrence.

Accelerating the rate at which B-52 bombers, Minuteman II ICBMs, and Poseidon ballistic-missile submarines are retired could result in some economies. Because their annual operating costs are relatively low, reducing the size of the remaining Minuteman III force would add very little. Any bigger cuts would have to be made by eliminating one or more of the 18 Trident submarines that the Navy now plans to continue operating into the 1990s. Because the most likely residual threats to U.S. territory will come from undeterrable acts of irrationality or pure accidents, a larger share of remaining resources should be devoted to some kind of anti-ballistic missile capability.

Remaining savings would have to come from forces intended for Third-World contingencies, especially those large aircraft carriers that presently have power projection as their primary mission. Although, in the near term, the United States will have to continue to be concerned with the defense of Persian Gulf oil reserves, in the future the most important form of power projection is likely to be, not the injection and sustained support of substantial, heavy ground forces, but the use of aerially delivered precision weapons to attack either the conventional military forces or the burgeoning unconventional warfare capabilities of hostile regional powers. Under conditions of severe budgetary constraint it makes sense to emphasize the extremely long-range air- and sea-based forces (especially cruise missiles) needed to conduct such operations.

William R. Hawkins

President Bush's FY1993 budget called for reductions in defense spending totaling $50 billion over five years. The president's recommendations in regard to nuclear weapons are sensible given the collapse of Soviet Communism, although termination of new systems like the B-2 bomber and Midgetman ICBM were justified in any event due to their high cost and limited value. Additional cuts in military spending should be sought in this area in tandem with cuts in Russian offensive systems. It is at this level that the end of the Cold War has had its most profound effect. A global ideological struggle could have boiled over into a need to "fight and win" a nuclear war, but with the return to a more normal political environment, a much smaller nuclear force can serve as a deterrent.

Conventional forces have done the fighting from Korea to Kuwait, and the U.S. depends on them for power projection and the active defense of overseas interests. The president has already proposed a more than 25-percent reduction in conventional manpower including the loss of six divisions, two carrier groups, and nine fighter wings by 1995. To reduce the defense budget by $50 billion more than Bush has proposed would require the balanced demobilization of three Army divisions, five air wings (at least two of which should be of the disappointing B-1 bombers), one carrier group, and roughly half the nuclear attack submarine force (provided equivalent percentage cuts can be negotiated with Moscow—nuclear attack subs should be considered strategic weapons).

Heavy Metal

The priority in this demobilization should be to keep heavier rather than lighter units. The low-intensity conflict (LIC) concept that gained popularity in the 1980s should have been buried in the Saudi desert. Earlier plans that envisioned the demobilization of the heavy armored and mechanized units assigned to NATO while retaining a "contingency army" of mainly light units must be reversed.

Proponents of LIC have cited the incidence of such wars as evidence of their importance. However, this kind of reasoning is a trap. It is strategic impact, not statistics, that determine the importance of a war. LICs drag on for years because neither side can muster the necessary strength to win. Governments are unable to completely eradicate guerrillas or terrorists while such insurgents are unable to seize control of the entire country or its centers of authority. It is indecisive warfare and thus not a strategic threat to American interests.

A conflict that remains in the LIC phase should be handled by local forces. American involvement should not go beyond the provision of weapons and training and perhaps the use of special operations forces (SOF). Should a conflict escalate beyond LIC, the U.S. response should be directed at the source of the increased threat—usually a sponsoring state.

American forces should provide its allies capabilities they cannot provide for themselves. That means air and sea power to isolate the battle zone, and sophisticated airmobile and heavy ground combat units against which the enemy cannot stand. Rather than develop forces geared to becoming entangled in LIC, the U.S. posture should aim at extracting allies from LIC by providing them with the means to wage decisive warfare.

The United States needs a strong SOF component for counter-terrorist and commando operations. The increase in SOF strength under President Reagan should be retained. However, the same cannot be said for the light infantry units created in the 1980s. Their missions can be left to the paratroopers and the Marine Corps. Eliminating light and non-mechanized infantry units, including independent brigades, to first meet reduction targets will allow the Army to keep two airborne, three armored, and five mechanized divisions.

These heavy forces will require more transport. However, maritime pre-positioning ships are less expensive than strategic transport aircraft, both to procure and to operate. The success of the Marines in this regard should be spread to the Army.

In the air, the reduction of tactical wings will place a premium on dual-purpose aircraft. A small force cannot afford specialized units even when, like the A-10, they

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

proved themselves in combat. Since all other operations depend on air supremacy, fighters and deep-strike aircraft must have priority.

Murray Weidenbaum

The United States continues to face a dangerous world, although the nature of those threats is changing. With the breakup of the Soviet Union, the greatest military danger is likely to arise in the developing nations, either from terrorist groups or from national leaders with visions of glory (à la Saddam Hussein). Novel responses will be required.

Simultaneously, we cannot ignore the inventory of intercontinental ballistic missiles, nuclear submarines, and other strategic forces located in the former Soviet republics. Although the current leadership seems peaceful enough, we do not know who its successors will be—nor can we forecast with any confidence whether any of those lethal forces will come into the possession of erratic groups, whether on the far right or the far left.

Thus, we need to maintain our defense capability and continue working on missile defenses. I always thought the two contending camps had it wrong on SDI. Those who proclaimed, even before the results of the developmental stage were available, that SDI could not perform its mission reflected their ideological orientation rather than any scientific knowledge. But a commitment to production before the test and evaluation phase is complete ignores the many cost overruns and delays on earlier projects. Former Deputy Defense Secretary David Packard had it right: fly before you buy.

One large part of the armed services can be promptly reduced: general-purpose forces devoted to defending NATO against Soviet attack. The USSR's advanced staging area for an assault on Western Europe, the former satellite nations of Eastern Europe, has become the buffer for the West.

More fundamentally, the ability of the Russian military to launch an invasion of Western Europe has dissipated. It would take many months—more likely years—before that offensive capability could be restored. With advanced communications systems, the United States and its NATO allies would have a great deal of warning. We can rely on reserve forces to provide the backup necessary should any contingency develop.

Procurement Reform

Given a 25-percent cutback of U.S. armed strength and substantial declines in procurement of offensive strategic systems and conventional general-purpose forces, a reduction of $100 billion in the annual level of military spending could readily be achieved. In fact, a reserve would be available to produce new weapons and equipment needed to counter terrorists and other unconventional aggressors.

Additional savings could be obtained by deregulating the military procurement process. Needlessly bureaucratic procedures add 20 to 30 percent to the cost of that expensive process. The most desirable approach is to eliminate the 2,000 pages of acquisitions regulations—and the 500 pages of standard clauses inserted into defense contracts and the 300 pages of standard forms—and then start over. They can be replaced with 100 pages of simple regulations.

That means eliminating the many extraneous socioeconomic provisions inserted by Congress. These include favoritism to domestic producers of jewel bearings and subsidies to "small disadvantaged business concerns." "Disadvantaged" is defined so broadly that it includes groups with annual incomes significantly above the national average. Congress's Office of Technology Assessment has noted, "While Congress did not intend the [military acquisition] system to be slow, cumbersome, and inefficient, laws passed to foster goals other than efficient procurement have made it so."

A new start to military purchasing would also toss out the micromanagement imposed by legislative committees. There is no good reason for Congress to establish tours of duty for program managers or to set rules for allocating overhead, or to require that Small Business Administration representatives be stationed in every major defense acquisition center to look at every spare parts contract. Inside the Department of Defense, economies can be achieved by eliminating the veto power of 40 line and staff officials over the efforts of the military program manager.

Reducing the overwhelmingly detailed regulation of defense production will save taxpayers substantial amounts of money. Of greater long-term benefit will be the restoration of the entrepreneurial orientation of defense contractors so that they can demonstrate the initiative and innovativeness that make private enterprise so much more effective than government bureaucracy.

Dov S. Zakheim

Force-planning for the better part of the past half-century has been dominated by a single primary threat to American security. Now we are reverting to the strategic outlook that faced America for most of its history: uncertainty about the precise nature of threats to its interests, but conviction that threats will likely exist for years to come.

The term "threat" has so come to be identified with the Soviet Union that its use in some regional contexts is something of a misnomer. In the Middle East, radical states and terrorist groups pose a tangible threat to U.S. interests. With the notable exception of the Korean peninsula, the "threat" to our interests in East Asia is far less precise. It resides primarily in the damage that a disruption of the delicate balance among Russia, Japan, and China might cause to the security of the region and to American interests, both human and economic, that reside there.

Moreover, it may be difficult precisely to gauge the degree of threat even in the Middle East. Today, Egypt is a friend, Iraq is a foe, Syria is friendly, while Iran is not. Ten years ago Iraq was a friend and Syria was unfriendly. Twenty years ago it was Iran that was friendly, while Egypt was not. Fifteen years hence, alignments could well change again, and with them threat assessments and force requirements.

Seen in this light, force-sizing and acquisition must

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

address a blend of responses appropriate to both tangible and intangible threats. The greatest emphasis must be placed not only on rapid deployability, mobile firepower, and commensurate support and training, but also on highly flexible forces with the staying power to show the flag in critical regions on a permanent basis.

Protect Mobility

A defense budget $100 billion lower than the current level could not even remotely sustain the blended force posture required to support American worldwide strategic interests. For example, assuming no change in currently proposed force levels, such a budget would yield fewer funds for procurement and research and development combined than the FY1993 budget provides for research and development *alone* (although the proposed 1993 levels are already about half those of FY1985). In other words, modernization—of all systems—would come to a crashing halt.

To ensure some degree of force modernization, force levels would drop precipitously. In allowing for such reductions, it is critical that we preserve at all costs those land forces that are flexible and deployable: the Army's airborne and airmobile divisions, and the three Marine divisions. We also cannot forgo our presence in Europe entirely, nor send the wrong signals in northeast Asia: two brigades must stay in Europe and the Second Division in Korea. Finally, at least two heavy divisions must remain in the active force in anticipation of another Middle Eastern conflict.

We cannot afford to foreclose our ability to maintain forward aircraft carrier deployments in East Asia and the Indian Ocean, as well as a near full-time presence in the Mediterranean. Thus, at least nine carriers must be retained in the fleet. Carrier battle groups could be smaller, and certainly do not require submarine escorts. Air wings could be combined, at least in part, with Marine aviation, and focus on power projection rather than defense of the battle groups.

With fewer than 20 active wings, the Air Force could not mount a credible campaign in the Middle East while maintaining high alert levels elsewhere, notably in Asia. We will have to increase our reliance on the Air Force reserves to supplement reductions in the active force.

Our ability to project rapid power overseas critically depends on our mobility forces. Sealift has been neglected far more than airlift, and in the postulated constrained budget environment, it is the ships, rather than the aircraft, that require funding priority.

Devastation of Morale

Procurement would be reduced commensurate with these lower force levels, but not eliminated entirely.

Reuters/Bettmann

"One large part of the armed services can be promptly reduced: general-purpose forces devoted to defending NATO against Soviet attack." —Murray Weidenbaum

Acquisition must preserve America's comparative advantages in tactical aircraft stealth technology (the F-22 in particular), maritime—especially carrier forces—command, control, and communications, electronic warfare, and, critically, strategic defense and GPALS, especially given the prospect of further mutual strategic offensive force reductions by the United States and Russia. All other programs would probably not survive.

The program outlined above, however, yields a decimated, obsolescent military, unable to respond adequately to more than one crisis, or to do so with any degree of sustainability. We need only look at today's Red Army to understand the devastating impact on the morale, efficiency, and effectiveness of our own forces if they were forced to function with less than two-thirds of the resources currently available to them. It is not a pleasant sight to behold.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Dirty Driving

Donald Stedman and the EPA's Sins of Emission

Rick Henderson

Ronald Reagan may have been right, after all, about "killer trees." The pundits snickered at him in 1980 when he alleged that trees are a major cause of pollution. However, a National Academy of Sciences (NAS) study published last December may vindicate the former president. In a 450-page report, *Rethinking the Ozone Problem in Urban and Regional Air Pollution,* the academy demonstrates that in Atlanta and other areas of the Southeast, vegetation emits more volatile-organic compounds (VOCs) than do automobiles and industrial activities combined. VOCs form ground-level ozone, or smog, when combined in sunlight with nitrogen oxides (which usually come from manmade sources).

The NAS study, required by the Clean Air Act of 1990, is one of the most important documents in the history of regulating air pollution. The report shoots down many of the assumptions that regulators have made over the past two decades about the formation of low-atmosphere ozone. Among the study's conclusions:

1) Regulators have been using faulty methods to measure ozone trends. The Environmental Protection Agency (EPA) caused enormous public alarm when it reported that 98 metropolitan areas were out of compliance with national air-quality standards in 1990, up from 63 in 1987.

But the NAS study suggests that the current EPA yardstick for measuring compliance is defective. According to the NAS report, the number of days an area can violate air-quality standards "varies considerably from year to year," with most of the variation coming not from "year-to-year changes in emissions" but from "natural fluctuations in the weather." Regulators therefore need to take more readings before they can take a reliable survey of actual ozone levels independent of changes in rainfall, temperature, or wind direction.

2) Current estimates of pollution by volatile-organic compounds are unreliable, because they are based on models that have not been tested against actual measurements in the atmosphere. VOCs include hydrocarbons such as benzene, methane, and isoprene, as well as other compounds such as formaldehyde. When VOCs enter the atmosphere, they combine with other airborne substances in complicated chemical reactions. Unless researchers and regulators precisely measure these substances—and the NAS report concludes they haven't—it is impossible to tell which pollutants exist in a particular area, and what threats they pose.

3) Cars are much more important sources of VOC pollution than most regulators currently assume. In some metropolitan areas, the NAS suggests, VOC pollution from cars has "been underestimated...by a factor of two to four." In the Los Angeles basin, for example, EPA and local regulators assume that cars cause around 60 percent of the pollution. The NAS study suggests this proportion is much higher, meaning the best way to clean up Los Angeles is to clean up its cars.

4) Federal and state regulators are going about cleaning up car pollution in all the wrong ways. The emphasis is on ever-tougher restrictions on emissions for cars coming off the assembly line, combined with required inspections of older cars to make sure their emissions-control equipment works properly. Manufacturers have already spent billions of dollars to build cleaner cars; motorists have spent billions more on inspection and maintenance programs. The NAS study concludes that these efforts haven't accomplished much, and that regulators will have to adopt a new approach.

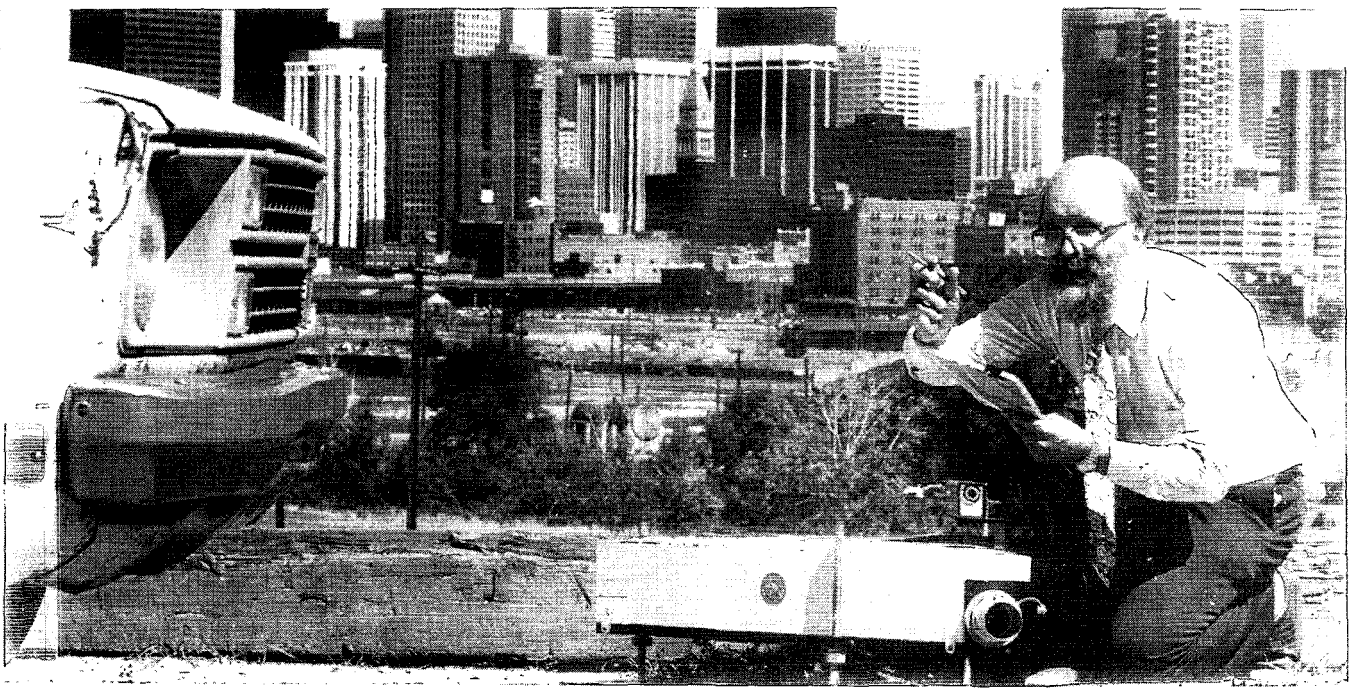
A Fraction of the Cost

Although the NAS report does not endorse any new approach to clear air regulation, it comments favorably on a simple and effective technology that can locate the source of most automotive pollution—the tiny minority of drivers who operate the dirtiest cars. Using this technology to find those drivers could reduce much of our urban pollution for a fraction of the cost of the proposed alternatives.

For more than two decades, Donald H. Stedman, a chemistry professor at the University of Denver who used to be an emissions tester at General Motors, has been dissatisfied with the ways researchers measure auto pollution. State and federal regulators traditionally test cars as they idle or they test cars on a dynamometer—a treadmill-like device. Researchers inside the EPA and

Rick Henderson *is Washington editor of* Reason *magazine.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED



Tom Cherrey

Stedman has designed a mobile testing machine that can identify the worst-polluting cars as they move along city streets.

elsewhere admit that idle tests are inaccurate; they underestimate the emissions cars emit while they are in gear. Dynamometers, while more precise, are expensive (the machines cost as much as $300,000) and cumbersome (each test takes 10 to 15 minutes to complete).

Stedman has designed a mobile testing machine that can identify the worst-polluting cars as they move along city streets. The chemist initially designed his sensors to monitor carbon monoxide pollution. In recent months, he has modified the device so it can also track hydrocarbon emissions. Within a year or so, he hopes to monitor nitrogen oxides as well. Stedman's portable, on-road emissions sensor can monitor as many as 1,500 cars an hour at speeds of up to 65 mph. He has tested more than 600,000 cars on three continents. And his findings annihilate much of the conventional wisdom about cars and the pollution they cause.

70 Percent of Cars: "Clean As Me Breathing"

What he has discovered about carbon monoxide and hydrocarbons is mind-boggling: 90 percent of the cars driving in the United States, regardless of age or emissions-control equipment, cause no significant pollution. Stedman's findings and the conclusions of the NAS study question most current proposals to reduce auto emissions. Indeed, random-testing programs featuring Stedman's device could make much of the Clean Air Act superfluous—especially its emphasis on alternative fuels, its beefed-up inspection rules, and its requirement that new-car emissions be 99 percent cleaner than in 1970.

Stedman's invention operates very simply. Instead of putting a wand in a car's tailpipe, the device shines a beam of infrared light at tailpipe level across a single lane of traffic. The light beam absorbs each car's carbon-monoxide or hydrocarbon emissions. Simultaneously, a video camera photographs the car's license plate, and, within 30 seconds, gives a readout of the pollution levels. The machine can be set up on an interstate on-ramp, or anywhere else one lane of traffic can be monitored at a time.

Most pollution regulators claim that all cars pollute, and that older cars emit much more than newer ones. Wrong, Stedman says: "70 percent of the cars we test are as clean as me breathing." His tests show that fewer than 10 percent of all cars cause more than 50 percent of total auto pollution. And 75 percent of the cars manufactured before 1975, the year federal regulators first required exhaust-catalyst pollution controls, run cleanly.

Research conducted over the past three years shores up Stedman's assertion. In 1989, researchers at California's Bureau of Automotive Repair, the agency that runs the state's smog-check program, randomly pulled over 3,742 cars and tested their emissions as they idled. The dirtiest 7 percent emitted 50 percent of all automotive pollutants. The cleanest 50 percent only emitted 3 percent of the total pollution. Other studies sponsored by the state's Air Resources Board (ARB), General Motors, the EPA, and the state air-quality agency in Illinois confirm these findings.

Tale of Two Tailpipes

Why do cars run dirty at all? Uniformly, the dirtiest cars (what Stedman calls "gross polluters") emit more than 4 percent carbon monoxide. But regardless of model year or emissions-control equipment, a car tuned and maintained according to manufacturers' specifications should emit only 1 to 2 percent carbon monoxide, even under the most severe engine strain. When Stedman has tested entries at classic car shows, he's found that these pristine models (which have no pollution-control equipment) emit no more pollution than those straight off the assembly line today. And last fall, when

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

he checked 347 cars in Great Britain that were all built before 1904, he found that most of them emitted less than 1 percent carbon monoxide.

But improperly maintained cars of any age can cause trouble. In spring 1990, Stedman brought his device to Washington, and tested cars driving near the Rayburn House Office Building. One 1987 taxicab emitted 13 percent carbon monoxide. When testers pulled the driver over and inspected the car, mechanics found a defective fuel injector. Biochemist Gary Bishop, one of Stedman's Denver colleagues, says the taxi operator "drives 35,000 miles a year. Thirteen percent at 35,000 miles [produces] six and one-half tons of CO. He was also losing 26 percent on his gas mileage." After receiving repairs costing less than $200, the cab emitted less than 1 percent carbon monoxide. Only this mobile testing device could have found that driver before his next scheduled emissions check.

Fuelish Alternatives

Until recently, pollution researchers and regulators treated Stedman's contention—that tuning up the 10 percent worst-polluting cars would reduce auto air pollution by 50 percent—as pure heresy. Pollution-control advocates want to reduce smog by getting people out of their automobiles and into electric cars, alternatively fueled vehicles, or subways. Others concentrate on expensive on-board sensing devices and old-car buyback programs. Each costs a lot of money; none delivers what mobile testing promises.

The best-known alternative fuels are the "oxygenated" substances methanol and ethanol. The NAS study describes pure methanol, which is derived either from coal or natural gas, as "a colorless, toxic liquid" that, when it burns, has a "nearly invisible [flame] in daylight, which may be a safety problem." Methanol's chemical attributes make it "difficult to start a vehicle...when cold, and high cold start emissions ensue." Methanol exhaust contains formaldehyde, a carcinogen. The study notes, "It is not clear whether methanol use will lead to lower [nitrogen-oxide] emissions."

Unlike gasoline, methanol is water-soluble. Swallow a jigger or breathe its fumes and you could go blind; one methanol tanker spill could contaminate the water supply of a small city. Methanol is also highly corrosive—methanol-fueled vehicles require corrosion-resistant equipment that costs as much as $2,000 to purchase and install.

Ethanol hardly rates better. A May 1990 study authored by former ARB chief Thomas C. Austin concluded that the standard "gasohol" mixture of 90 percent gasoline/10 percent ethanol could cut carbon-monoxide emissions by 25 percent but that hydrocarbons would rise by as much as 50 percent and nitrogen oxide by 15 percent.

Moreover, because gasohol gets a 6-cents-per-gallon subsidy (or 60 cents-per-gallon for pure ethanol), ethanol-using motorists "end up paying more for dirtier air," as Austin points out.

Reformulated gasoline holds some limited promise. You can use it in existing cars. And it does cut pollution—slightly. Until now, individual refineries have developed reformulated gasoline on their own. Now California plans to mandate that all gasoline in the state must burn 30 percent cleaner before the year 1996. To comply with this requirement, refineries say they will have to invest as much as $5 billion to gear up for the new fuel. Consumers will see gas prices rise as much as 20 percent. And state officials concede this new gasoline *might* reduce total smog by 5 percent.

Stedman has little patience with such mandates. He argues that, if a car runs dirty because it's out of tune, no formulation of fuel will clean it up. "The federal government's own data base [recommending clean fuels] shows that tuning up a few dirty cars would be nearly twice as effective as oxygenating the whole fleet." In 1989 the EPA tested 84 cars to compare their emissions when they ran on gasoline and oxygenated fuels. The four dirtiest cars caused 46 percent of the fleet's pollution. Merely tuning up those four cars would have cut total pollution by 43 percent; however, fueling all the cars with oxygenated fuels would have cut the fleet's smog by only 28 percent. When you also include the additional costs and the potential health hazards of using oxygenated fuels, dirty-car tuneups win by a mile.

Other alternative fuels, such as compressed natural gas, hydrogen, and propane, burn cleaner than gasoline. However, few vehicles—and even fewer fueling stations—exist for these fuels. Still, some cities may soon be able to replace their diesel-fueled bus fleets with buses powered with compressed natural gas. It will be some time before any of these could conveniently replace conventional passenger cars.

Electricity without Power

The high-tech crowd loves electric cars. But they aren't practical either. When Stedman tested 347 pre-1904 cars, electricity powered seven of them. "Electric cars were just around the corner then," he says. "When I went to work for General Motors in 1970, electric cars were still just around the corner." So, why aren't more electric cars on the road? Lack of horsepower. "Have you ever seen an electric car with a heater or air conditioner?" Stedman asks. "They don't have enough power to push them."

The NAS study notes that using fossil-fuel power to generate the electricity to run electric cars would cause virtually as much pollution as the gasoline-powered cars you replaced. Also, the batteries in most electric cars last only a few thousand hours; getting rid of them is a thorny disposal problem.

The American Automobile Association and many EPA regulators favor on-board electronic sensing devices. Supporters say that, with these computerized devices in use, mechanics could plug the car into a diagnostic machine and identify how much pollution a car emitted over time. However, current schemes would require these devices only on new cars. And the devices would jack up the price of a new car from $600 to $1,000, encouraging motorists to keep their older cars and not take advantage of the technology.

Also, Stedman contends, these devices aren't tamper-proof. Because the on-board machine uses a microprocessor to provide data, people who wish to delay

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

maintenance and repairs could reprogram the chips to report that their car didn't pollute. "You can get a computer to say anything you want it to," he notes.

Buyback programs pay owners to retire older cars. In 1990, Union Oil of California (Unocal) offered 7,000 drivers $700 each to turn in their pre-1971 cars. The Bush administration has proposed pollution enforcement incentives for companies that pay drivers to retire old cars. University of Southern California transportation planner James Ortner argues that "Pre-'71 cars aren't the problem. When the [pollution-control] equipment fails on the 1975–79 model cars, they pollute worse than older cars." Stedman has found that, once a fleet of cars gets 12 years old, it doesn't get any dirtier. This isn't surprising: If you own an old car, and drive it frequently, chances are, it's in sound mechanical condition.

Stedman and his supporters argue that mobile, on-road testing should not merely supplement but replace traditional pollution inspections. Here's how a citywide program might work. When motorists registered their cars, they would mail in their usual inspection fees. But they wouldn't have to take a smog test; the money would finance random tests and assist with repair costs for gross polluters. (Stedman calls these fees "pollution-insurance premiums.")

Testers would set up mobile devices at random locations across the city. A nearby video camera would photograph the license plates of the gross polluters. Local officials could then match license plates with vehicle-registration records and mail a notice to the owner of each car, requesting him to repair the car. If he were caught again within, say, 60 days, the city could require him to take his car to a central testing location for a thorough diagnostic test—at the owner's expense. Since nine out of 10 drivers don't pollute, the "pollution-insurance fund" would accumulate a surplus; local officials could use part of that surplus to provide "clean-up vouchers" to drivers who can't afford repairs.

Experiment in Provo

Stedman conducted a program resembling that model this past winter in Provo, Utah. With the assistance of Shell Oil Company and the World Wildlife Fund, Stedman hoped to identify 50 gross polluters, repair those cars, and then see if even that modest effort would improve the area's air quality. By early February, 50 gross-polluting cars had been identified by the infrared sensor twice. Testers then mailed notices to the owners of those cars and followed up with telephone calls. Twelve drivers accepted free repairs. "All of these cars had *big* problems," Stedman says. In particular, one car emitted 13 percent carbon monoxide even though the owner had taken it in for repairs on two earlier occasions. The repair crew's diagnostic equipment found and replaced a faulty starter; the car's emissions dropped to 0.3 percent carbon monoxide. (At press time, the program was still under way. It's too soon to tell if Provo's air is indeed any cleaner.)

Citywide programs could use other ways to notify the owners of gross-polluting cars. California testers have placed a video monitor in a van near the testing machine; whenever the device identified a gross polluter, a person in the van signaled a nearby state trooper who would stop the driver. The trooper would then ask the driver if he could examine the car's smog-control equipment to make sure it was functioning properly.

At that time, researchers unintentionally discovered another unique advantage of on-road infrared testing: identifying drivers who evade smog inspections by altering the emissions-control equipment on their cars. The Bureau of Automotive Repair says 25 percent of the cars they pull over and inspect show some signs of tampering.

During a June 1991 test on Rosemead Boulevard in Los Angeles, troopers pulled over nearly 300 gross polluters at random; on inspection, they found that 41 percent of the owners had deliberately altered their pollution-control equipment. Most, if not all, of these drivers had evaded the state's mandatory smog-check program.

A New Tool for Law Enforcement

These test results got the attention of Los Angeles County District Attorney Ira Reiner. The county has its own pollution-enforcement division, and earlier coverage of remote sensing in the *New York Times*, *Business Week*, *Reason*, and elsewhere had intrigued Reiner's staff. Some officials estimate that as many as 40 percent of the cars in the Los Angeles basin are unregistered and never undergo smog inspections. Reiner believes that illegally altered and uninspected vehicles cause a substantial amount of pollution; he sees mobile, remote sensing as the only way to find those cars.

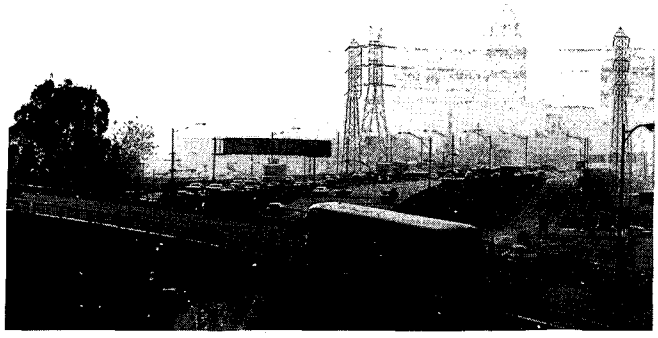
Random testing featuring Stedman's device could make much of the Clean Air Act superfluous.

Reiner asked the state to purchase 100 infrared devices for the sole purpose of rounding up gross polluters. Deliberate tampering would draw a stiff fine; drivers who merely needed repairs could get cleanup vouchers to help defray their costs. Reiner's office estimates that the program would generate $50 million in fines each year—plenty to pay for the program.

In September, a report issued by the state senate Office of Research gave Reiner's concept a boost. The report said the state's biennial smog checks were inadequate, defended Reiner's proposal, and urged the adoption of a Stedman-style testing program to identify all gross polluters.

State regulators disagree. The Air Resources Board, which has cosponsored studies with Stedman, refuses to sanction such a program. The agency backs the device as a means to collect data, but spokesman Bill Sessa has told the Los Angeles *Daily News*: "The assumption that you could in some way use [remote sensors] for en-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED



AP/Wide World Photos

Effective emissions control would focus on tuneups for the fewer than 10 percent of cars that cause more than half of all auto pollution.

forcement purposes is absolutely not valid."

Other regulators, along with businesses and environmental groups, want to give remote testing a chance. On February 6, 1992, Democratic state Senator Gary K. Hart of Santa Barbara (no relation to the 1984 presidential candidate) introduced a bill permitting air-quality districts in the Golden State to use remote testing to find gross polluters.

California has its own clean-air act, and it's tougher than the federal law. Each regional air-quality management district in the state must periodically examine its pollution-control plan and evaluate the cost-effectiveness of each component. The law requires legislators and regulators to find the least costly methods to reduce pollution in their districts. Hart's bill would require each air-management district to develop a remote-testing model. It also permits the districts to use remote testing to identify gross polluters and gives them the authority to require repairs. Each district would then compare remote testing's costs and benefits with the other emission-control measures they plan to use.

A broad coalition backs the bill: Representatives from the Sierra Club, the California Council for Environmental Balance (a business group), and the South Coast Air Quality Management District (which regulates the Los Angeles basin) joined Hart at a press conference when he introduced the bill.

Seeing Infrared at the EPA

Although local governments are eager to put Stedman's technology to use, high-level officials at the EPA in Washington are trying to prevent the random testing device from being deployed. The Clean Air Act of 1990 was intended to provide a different approach to tackling air pollution. Instead of top-down regulations, the government would control pollution through market mechanisms: emissions trading, incentives (not mandates) to recycle, and the like. Representative Joe Barton (R–TX), a member of the House Space, Science, and Technology Subcommittee, sees mobile testing as an excellent example of this new thinking in practice. Barton sponsored Donald Stedman's spring 1990 trip to Washington. He was so impressed with the infrared device that he added an amendment to the Clean Air Act requiring the EPA to allow states to include on-road emissions testing as part of their inspection-and-maintenance programs.

But the agency has, in effect, thwarted states from using random testing with the infrared device as a way to enforce the Clean Air Act. When a state's or a local region's air is dirtier than the law allows, the EPA requires that region to develop a pollution-reduction plan. EPA regulators then allocate "credits" to the various components of the proposal. If the plan doesn't earn enough credits to gain EPA approval, that area could lose federal funding or other benefits. Stedman complains that these "clean air credits," not clean air itself, drive state policies. A congressional aide agrees. "Credits are the key," the aide says. "States are more worried about how they can get credits to satisfy the law than they are about actually cleaning the air." The trouble is that, even though the administration quickly gave credits to its ill-conceived buyback program, the EPA continues to deny clean-air credits for random mobile testing.

Last spring, Barton introduced an appropriations amendment requiring the EPA to spend $4 million of its budget on mobile-testing research. However, the EPA has allocated only $100,000 for research in fiscal year 1992 and nothing for fiscal year 1993. Barton also asked EPA Administrator William Reilly to give California—or any other state—clean-air credits for random mobile testing. The agency refused. In December, Representatives William Dannemeyer (R–CA) and Thomas Bliley (R–VA), the ranking minority members on the House Environment and Oversight subcommittees, asked Reilly to report on the status of infrared testing and clean-air credits. Another refusal.

The EPA's objections, as articulated by Don Zinger, assistant to the director of mobile sources, are that a random testing program won't check every vehicle. Some drivers will also evade the testing device. And no state has yet offered a detailed proposal explaining what sanctions it will issue to the owners of gross-polluting vehicles. Barton counters that as long as the air gets cleaner, the federal government should "leave it up to local authorities to determine how to use [mobile testing]."

A program using Stedman's infrared device could force polluters to pay for the damage they cause. Gross polluters would either have to repair their cars or pay hefty fines; most motorists could continue to drive without penalties as long as their cars ran cleanly. Stedman says requiring each driver to take a smog test is much like forcing every resident of a crime-ridden neighborhood to spend 15 minutes in jail. A mobile-testing program could replace the scattershot approach of mandatory emissions tests with a targeted system that both cuts pollution and reinforces individual responsibility at much lower cost. So why is it being suppressed by the EPA? ☎

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

JOIN TOWN HALL: THE NETWORK CONSERVATIVE GROUPS ARE TURNING TO

Let's face it: Leftist organizations are so . . . coordinated. They're so . . . "networked." Just ask Robert Bork.

When it comes to "networking," conservative organizations have made big leaps in recent years. But too often, when a conservative organization engages in a policy battle, it can find itself fighting alone. Without allies.

Until now.

The *new* TOWN HALL, the computer-based conservative meeting place, is the locus where conservative organizations assemble and coordinate their policies, ideas and strategies—with the immediacy and intimacy they've never before enjoyed. TOWN HALL is an easy-to-access, secure setting where conservative groups and individuals can "network" with each other. TOWN HALL is a friendly and affordable conservative "inner sanctum" where the "Right" groups can plot, debate and plan—either internally or with other groups—on how to win that policy fight. Together.

TOWN HALL turns your phone-linked computer into a huge office building that only conservatives can enter. It's a place where your organization maintains a secure, private "office" suite: where a group can hold conferences between far-flung national, state and local affiliates, or communicate via our state-of-the-art electronic mail system. Where you can research a critical issue and gain immediate access to important policy papers in the TH library, or allow individuals in different states to work together—at the same time—on an organization publication or direct mail piece.

And while TOWN HALL lets your organization network internally, our computerized piece of real estate is also the setting where your group can network with other conservative groups—the same groups which would have helped in that last policy fight, but which your organization couldn't coordinate with quickly enough—whenever you want, 24-hours-a-day.

Now with TOWN HALL—a joint project of National Review and The Heritage Foundation, two trusted conservative institutions—your organization, whether it be a Washington-based monolith or a small-but-dedicated local outfit, can conference with other conservative groups or individuals, share information and ideas, market products and publications, poll conservatives, and much, much more.

TOWN HALL's functions are endless. So when your group opens a TOWN HALL office, you'll not only increase your access to the rest of the conservative movement, you'll increase productivity.

TOWN HALL
The Conservative Meeting Place

To open your organization's office, or to get more information about TOWN HALL, contact Jeanne Allen, TOWN HALL Executive Director, at 1-202-546-4400. To open an individual account today, call 1-800-441-4142. Or maybe you'd like an online tour. Just dial by modem 1-800-648-6964.

A Project of NATIONAL REVIEW and THE HERITAGE FOUNDATION

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Lady's Not for Turning

The Domestic Triumphs of Margaret Thatcher

SPENCER WARREN

Margaret Thatcher, like her friend Ronald Reagan, was an improbable figure to become one of her country's great leaders. A grocer's daughter, she was the first woman to lead a major Western party. Like Reagan, she was scorned and ridiculed by her country's political and intellectual establishment. Many in her own party thought she was not up to the job.

But together, they led a populist conservative movement that reshaped their own countries and much of the world. In a speech to The Heritage Foundation last September, Thatcher summed up President Reagan's achievement in one sentence: He "won the Cold War without firing a shot." Her achievement likewise can be summarized: She halted her nation's seemingly inexorable decline and restored her people's confidence and self-respect.

"English Disease"

When Thatcher took power in May 1979, Great Britain seemed to be in the terminal stages of the "English disease," a protracted decline resulting from militant trade unionism, poor management, stop-go policies, and alleged cultural hostility to enterprise. Keynesian fiscal policy, coupled with a strong socialist movement—both long accommodated by prevailing Tory pragmatism—had produced a top-heavy public sector that was choking economic creativity. Government consumed 42.5 percent of gross domestic product and the top income-tax rate stood at 83 percent (98 percent on investment income).

Unions were paralyzing industry and making the country ungovernable. Five times as many working days were lost to strikes in the 1970s as in the 1960s. A coal miners' strike in 1972 had caused the Conservative government of Edward Heath to reverse its free-market policies with a U-turn that led to regulated wages and government subsidies to weak industries. Another miners' strike in 1974 brought down the government altogether.

In 1974 the new Labour government of Harold Wilson granted the miners a huge pay increase. Big wage hikes, with the added impetus of the first oil-price shock, sent inflation soaring to 24 percent in 1975. That year, the government negotiated a "Social Contract" with the Trades Union Congress (TUC), in which the unions pledged to limit wage increases in exchange for government efforts to hold down prices and carry out an industrial policy. This extra-democratic involvement of the unions in government policy prompted some to complain of "corporatist" government in Britain.

Government spending skyrocketed amid double-digit inflation, and the pound sterling came under heavy pressure. Much like a Third-World country, the government was forced to negotiate a loan from the International Monetary Fund, which required it to reduce spending and limit growth of the money supply.

In 1979 Britain hit the nadir of its postwar fortunes. In July 1978 the TUC had rejected the government's proposed 5-percent pay guideline for the Social Contract. A series of strikes at year's end then exploded into the "Winter of Discontent." Truck drivers, some rejecting the offer of a 25-percent pay hike, were followed by train engineers, causing massive layoffs in industry. More than 1.5 million local government and hospital workers began a series of one-day walkouts, leading over 1,000 hospitals to turn away all but emergency cases. Schools closed, garbage piled up in the streets, and in some areas the dead lay unburied. Mass secondary picketing at times erupted in violence. In the face of this anarchy, the government of Wilson's successor, James Callaghan, stood largely helpless. Finally, in March 1979, it was defeated on a motion of no confidence related not to the crisis but to the devolution of powers to Scotland and Wales.

In the subsequent election, Thatcher and the Conservatives swept into office with the biggest vote swing since Labour's 1945 landslide, gaining a decisive overall majority of 43. The campaign presaged the Reagan victory a year and a half later: in a historic reversal, conservatives stood as proponents of change and reform and the Left as defenders of the status quo and stagnation. Denouncing socialism, Thatcher, like Reagan,

SPENCER WARREN, *formerly a member of the State Department's Policy Planning Staff and counsel to a U.S. senator and a member of the House, is a writer living in Virginia.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Drawing by Alexander Hunter for *Policy Review*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

proclaimed that the state was the obstacle to, rather than the agent of, progress.

Curbing Union Lawlessness

The eventual turnaround of the economy under Thatcher was extraordinary. She stopped Britain's slide into senescence with four major achievements: bringing trade-union power under the rule of law; reducing the bloated state sector and reviving the market; sharply reducing high marginal rates of taxation; and controlling inflation, at least until decade's end. These in turn made possible Britain's most prosperous postwar expansion.

Union lawlessness more than any single factor brought Thatcher and the Conservatives to power, and labor reforms stand out in her legacy. She erected a legal framework for labor–management relations and restored to managers the right to make decisions. As important, she strengthened members' democratic control over their unions.

Belying her confrontationist image, Thatcher reluctantly agreed to reform in stages. The first two laws, enacted in 1980 and 1982, banned secondary picketing and made unions liable for unlawful strikes. The third law, in 1984, provided government funds to finance regular elections of union leaders and required a pre-strike ballot of members to authorize a strike. The fourth, in 1988, added to earlier restrictions against the closed shop and gave legal protection to members against union reprisals if they refused to support a strike.

These reforms reduced the number of worker-days lost to strikes from almost 30 million in 1979 to 4.3 million in 1981 and 2.5 million in 1990. The 800,000 figure for 1991 was the lowest since records began 100 years ago. Membership in the TUC fell by one-third.

Thatcher allowed union militants to tie their own nooses. Remembering the fate of Edward Heath in 1974, she conceded the miners' demands when they threatened in 1981 to strike against closure of unprofitable pits. She wasn't ready then, but, with energy stocks high, she was waiting when they came back in 1984. The union's Marxist leader, Arthur Scargill, called a strike without a vote, and from the start did not have strong worker backing. Violent secondary picketing turned an already hostile public, including many union members, further against him. In one of Thatcher's greatest victories, the strike collapsed a year later in April 1985.

Reducing Public Sector Bloat

Privatization was another signal achievement. In 1979 nationalized industries consumed 10 percent of gross domestic product (GDP), 15 percent of net investment, and 8 percent of employment. They were overmanned and inefficient, and government subsidies to prop them up were a serious drain on the budget. Overall, the public sector provided 30 percent of all jobs.

Beginning with British Petroleum and British Aerospace, Thatcher embarked on the most ambitious privatization venture in the Western world. By the end of the decade she had sold Britoil, seaports, Sealink (harbor and ferry service), Jaguar, British Telecom (the national telephone network), British Gas, British Airways, the airports authority, Rolls-Royce, British Steel, and the electricity and water authorities. Coal and railways remained the only big state industries. More than two-thirds of the industrial assets owned by the state in 1979 were sold or have been scheduled for sale, reaping about £33 billion and shifting 900,000 jobs to the private sector. The number of state industry and government jobs, which rose from 6.6 million in 1971 to 7.4 million in 1979, fell to 6.1 million in 1989.

Companies such as British Steel were transformed from grossly inefficient dinosaurs into world-class competitors. British Steel was costing the taxpayers over £1 billion per year in the early '80s. Privatized, it earned a profit of £733 million in 1989-90. In addition, privatization lowered costs for consumers. British Telecom's prices fell by more than 20 percent in real terms in seven years, and British Gas's prices fell by 13 percent in five years.

This truly radical reduction in government was a sharp departure from traditional Toryism. Lord Stockton (the former Conservative prime minister Harold Macmillan) complained that Thatcher was selling off the family silver. Thatcher's vision was truly populist, and she achieved her dream of a property-owning democracy. The number of shareholders quadrupled to almost 12 million in 1990, 24 percent of the adult population. In some cases, such as road hauling, public enterprises were sold to their own employees.

Thatcher further promoted popular capitalism by selling public housing to tenants at big discounts. Since enactment in 1980, one million new families have become home-owners, raising the percentage of the home-owning population from 52 to 66 percent. The sale of public housing, even more than the spread of share ownership, has had a profound significance for social mobility and for cracking Britain's class structure. As Peter Jenkins put it in *Mrs. Thatcher's Revolution*:

> In the West Midlands at the time of the 1987 General Election were families who, having bought at a discount for, say, £8,000 council houses valued at, say, £12,000 in 1982, knew of similar houses which had changed hands for over £20,000 at current [1987] prices. It was not just a case of a garden path to call your own, here was financial security among the working classes of a kind known previously only to the middle classes. Here was something to hold on to and hand on to children; and as children who were already buying their own houses on mortgage inherited houses or shares of houses from their parents, so wealth—capital!—would accumulate.

No wonder the Conservatives widened their inroads among Labour voters: the Labour party opposed these sales.

Reviving the Market through Competition

The Thatcher government further revived the private sector by promoting market competition. Deregulation of financial services in 1986 helped to preserve London's place at the center of world commerce. Earlier, as one

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

AP/Wide World Photos

Worker-days lost to strikes fell from 30 million in 1979 to 800,000 in 1991, as Thatcher brought union power under the rule of law.

of its first actions, the government had abolished dividend and foreign-exchange controls to facilitate free movement of capital. Thatcher dared to open up competition in that most Tory of professions: the law. She removed the monopoly of solicitors on house sales and of barristers on appearing in court. Opticians lost their monopoly on eyeglasses. Further, enterprise zones were invented in Britain, with 24 created between 1981 and 1983 alone. Similar "freeports" were created near airports or seaports of depressed areas. Thatcher also required some contracting out of public services in the National Health Service (the system of nationalized health care) and local government.

Even education was opened to the bracing air of the market. Laws were enacted in 1980, 1986, and 1988 providing for parental choice, a national curriculum, publication of school-by-school performance on standardized tests, school management of their budgets, and equal representation in school bodies of parents with local education authority appointees. Particularly controversial was a provision allowing any of 27,000 publicly funded schools to "opt out" of local education systems—often controlled by left-wingers—by vote of the parents. These schools now acquire independent status and receive direct funding from the central government. Educators not surprisingly were generally quite hostile and Labour was opposed. Once again it was the Tories advocating reform, reducing bureaucratic control, spurring competition, and raising standards.

Even now these reforms are being extended. Smaller primary schools will get the same rights as other schools to manage their budgets in April 1992. Open enrollment, a corollary of parental choice, will be extended from secondary to primary schools in August.

Choice and opting out, like union reform and expanding property ownership, gave people more control over their lives, helping to reverse the '70s trend in which large collectivist bodies (the state, state-owned industries, and trade unions) were growing more powerful.

Tax Reform

Thatcher also moved to reduce the punitive disincentives of Britain's tax system. "Absurdly high marginal rates," to quote Thatcher's 1979 campaign, were cut in her first budget, the standard rate falling from 33 percent to 30 percent and the highest rate from 83 percent to 60 percent. The surcharge taking a crippling 98 percent of investment income was abolished. Personal exemptions were raised, and the corporate tax on small companies was limited. To maintain its tight fiscal policy, which, with strict monetarism, was the main weapon against inflation, the government balanced these cuts with big increases in consumption taxes: value added tax (VAT) was hiked from 8 percent to 15 percent.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The boom that ensued from Thatcher's early discipline produced (with North Sea oil revenues) a budget surplus in 1988 and 1989. This permitted tax reforms in 1987 and 1988 similar to those of the United States in 1986: the standard rate was cut to 25 percent, with a single top rate of 40 percent, less than one-half the 1979 figure. Earlier, the corporate tax had been cut from 52 percent to 35 percent, and capital gains had been adjusted to eliminate taxation of inflationary gains.

Although taxation as a portion of GDP did not change much overall, rising from 38 percent in 1979 to 42.8 percent in 1982 before falling to 39.7 percent in 1989, all income groups benefitted significantly over the Thatcher years, thanks to the growing economic pie.

A former Tory prime minister complained that Thatcher was selling off the family silver.

Real weekly earnings for a median family of four, after deducting for income tax and National Insurance contributions, rose 23.9 percent from 1981 to 1989, compared with 9 percent from 1971 to 1981. Earnings for families in the lowest 10 percent rose 13.9 percent from 1981 to 1989 against 8.6 percent in the 1970s. The highest 10 percent rose 36.8 percent against 12.1 percent in the 1970s.

And, as in the United States, the supply-side effect was seen in the rich paying a higher proportion of income tax. In 1981–82, the top 10 percent paid 35 percent of the total tax; in 1989–90 they paid an estimated 40 percent—despite lower rates. The lower 50 percent in this period went from 19 percent to 16 percent. The average rate for a single person on average earnings fell from 23.7 percent to 19 percent, and millions of low-income earners were removed from the tax rolls.

Controlling Inflation

Until the late 1980s, control of inflation would have ranked with union reform at the top of Thatcher's economic achievements. Under pressure of the two oil-price shocks, union lawlessness, and poor productivity, prices rose an average of 14.5 percent per year from 1971 to 1976 and 13.4 percent from 1976 to 1981. When Thatcher took office in May 1979 inflation was running at about 10 percent. Conditions then worsened. The near doubling of VAT, coupled with the second oil shock and large public-sector pay increases (proposed by a special commission that she had promised during the campaign to support), helped send inflation soaring to 21 percent one year later. The deep recession resulting from the government's anti-inflation policies and other factors caused unemployment to rise from 5.4 percent in May 1979 (1.2 million) to 12.7 percent (three million) in January 1982; it reached 15 percent in some northern areas. GDP fell 3 percent during her first year and industrial output dropped 11 percent from 1979 to 1982.

As the crisis deepened, however, Thatcher stuck to her course. Government's role in the economy was to be reduced permanently and there would be no more Keynesian pump-priming, which would only worsen inflation. The March 1980 budget raised excise taxes further. More important, it announced a medium-term financial strategy, which for the first time stated the government's monetary targets over a period of four years. These strict limits, although overshot in practice, gave more evidence of the government's resolve and helped to reverse inflationary expectations.

The April 1981 budget marked the crucial point of Thatcher's premiership. Having failed to obtain the requisite spending cuts from the departments, the Chancellor of the Exchequer, Sir Geoffrey Howe, raised taxes by £5 billion and rejected public works to relieve unemployment. Such fiscal tightening in the depths of a recession was unprecedented since the advent of Keynesianism. A year before the Falklands War, the 1981 budget demonstrated Thatcher's courage and fortitude.

Three-hundred-sixty-four economists published a letter stating that "present policies will deepen the depression...and threaten...social and political stability." Protests mounted and inner-city rioting broke out in the summer of 1981 (and later, the autumn of 1985). Convinced that Depression-era levels of unemployment would spell defeat at the next election, "wets" in her own party, including most of the old-Tory gentry in the Cabinet, demanded reflation; there was talk of the inevitable U-turn, by which Thatcher would abandon her presumptuous new course and fall back on the old consensus. But she was defiant, declaring to the October 1980 party conference: "You turn if you want to. The lady's not for turning."

Soon her perseverance was rewarded. Inflation fell to 4.9 percent late in 1982 and stayed between 4 and 5 percent until 1988.

Thatcher's Boom

Britain now embarked on its longest sustained postwar expansion. Growth averaged 3.15 percent a year from 1982 to 1989 and 4.4 percent from 1986 to 1988. Europe's former "sick man" bested the European Community's growth of 2.5 percent per year from 1982 to 1989. Notably—and as in the U.S. expansion of the 1980s—growth did not rekindle inflation, at least until later in the decade. Both countries conquered stagflation. Real household disposable income per head rose 34 percent from 1981 to 1989, above the 24 percent from 1971 to 1981. Strong growth reduced the government's share of the economy, which had risen during the recession, to 40.9 percent in 1989, the lowest level since 1973. Growth and tight spending control (annual average real spending rose only 1.2 percent from 1979 to 1990) are the only tools for reducing the size of government.

True to supply-side predictions, investment was particularly strong. After big declines in 1980–81, gross private non-residential fixed-capital formation rose an annual average of 8.4 percent from 1982 to 1990, almost three times the 1971–79 figure and comparable to Japan's 9.1 percent. It climbed to double digits in 1984,

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

1985, and 1987, and the increase of 20.3 percent in 1988 was the biggest of any Group of Seven country since at least 1971. From 1982 to 1990, the European Community (EC) averaged 5 percent.

Growth in manufacturing productivity was especially strong, surpassing not only that of the United States but also Japan; it rose an annual average of 4.2 percent from 1979 to 1988, compared with 3.3 percent for the United States and 2.4 percent for Japan. This reversed the poor 0.7 percent rate from 1973 to 1979 and surpassed the 3.6 percent rate of growth from 1960 to 1973.

Unemployment remained in double digits until 1987, but then fell rapidly, hitting 5.6 percent early in 1990, well below the EC average (and, as with faster growth, reversing recent history). Thatcher's policies gave a big boost to job creation; from 1982 to 1989, Britain created more new jobs than the rest of the EC combined, averaging twice the EC rate of increase. From 1987 to 1990 Britain even surpassed the strong U.S. rate.

Thatcher's policies also spurred entrepreneurship. From 1979 to 1987 there was an average net increase of 500 new firms a week. The 1980s saw more than a 50-percent increase (1.2 million) in the number of self-employed, more than six times the increase of the previous 30 years. The venture capital industry grew from virtually nothing to over £1 billion in 1987.

Sadly, the recovery never reached areas of the north or old industrial cities such as Liverpool, where prospects remain bleak for many in the younger generation. Some of the improvement in manufacturing productivity is attributable to shedding of workers in heavily overmanned industries in these areas. But current conditions seem more the result of decline under the old policies; these areas had been carried on the government's shoulders and, though it may seem hard, only a strong dose of Thatcherism can open vistas to a brighter future over the longer term.

The worst setback of the Thatcher years was the resurgence of inflation at decade's end. This has been blamed on an overheating economy, and on policies of the Chancellor of the Exchequer, Nigel Lawson, in loosening the money supply following the October 1987 U.S. stock market crash, and in having the pound shadow the deutsche mark; others blame Thatcher's opposition to joining the EC exchange-rate mechanism until late 1990. Inflation reached 10.9 percent in October 1990, once again well above Britain's competitors. It has taken another severe recession to bring prices under control, but they will have risen about one-third from 1987 to 1992. Unemployment reached 9.2 percent in January 1992, and is projected to rise further. But at least Thatcher and her successor had the courage and honesty to ignore Labour demagoguery and administer, as she had earlier, tight money's bitter medicine, without which there can be no lasting recovery.

Thatcher and Reagan

Max Weber defined the charismatic politician as a leader possessed by an inner calling who inspires belief in others. Such a leader lives "for," rather than "off," politics. He is fired by a passion, disciplined by a sense of responsibility, and made wise by a sense of proportion. Too often, a politician blithely abandons any ultimate ends in pursuit of "personal self-intoxication." A mere "power politician," he may get "strong effects, but actually his work leads nowhere...." The charismatic leader, on the other hand, uses power in pursuit of a higher end, and thus shapes reality.

Thatcher and President Reagan were charismatic leaders. Others in their positions might have implemented generally conservative policies, at least before the recessions of the early '80s, but they would never have gone nearly as far in overturning their parties' orthodoxies. Their convictions marked them among their nations' most successful leaders: Thatcher was the longest consecutive-service prime minister in 160 years, and Reagan, the first president in 30 years to serve two terms, restored the luster to a tarnished office.

Arm in arm, their unflinching advocacy of liberty and capitalism reinvigorated national confidence and Western ideals, helping to fuel the passion for freedom in Eastern Europe, the Soviet Union, and elsewhere.

Britain under Thatcher shed its "sick man" label and embarked on its longest postwar expansion.

Thus, they contributed to the revolutions of 1989 and 1991, and to the worldwide shift toward free markets and pluralism. They proved the truth of Keynes' observation that "the power of vested interests is vastly exaggerated compared with the gradual encroachments of ideas."

Reagan started more quickly in office, winning historic economic policy changes in his first seven months. He slowed down—but could not reverse—the growth of government. The economy did quite well after the severe recession, posting strong growth with low inflation. Employment, income, productivity, and investment recovered (the latter moderately) after major declines in the late 1970s. The deficit proved a vital tool for holding in check the special-interest Congress, and strong growth brought it down to 1.7 percent of GNP (including state and local finances) in 1989, close to the 1 percent for the Group of Seven (although U.S. savings remained low).

But Reagan was stymied by the diffusion of power in the United States. Party weakness, the rise in ticket-splitting, gerrymandering, and the growth of incumbency advantages arising from decades of one-party control of Congress prevented any realignment like that of the 1930s. Reagan might have tried to do more to overcome these structural obstacles, but he often seemed reluctant. His 1984 "feel good" campaign won him a landslide, but did little for Republican numbers in Congress. He vetoed only 78 bills (compare with Roosevelt's 635 and Ford's 66). He allowed monster continuing resolutions to be-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

come a regular practice and tolerated unprecedented congressional interference in foreign affairs. Congress's growing use of the criminal law as a policy weapon against the executive culminated in the Iran–Contra affair, which resulted in part from his departure from stated policy on terrorism.

Thatcher, by contrast, started slowly but picked up full steam after her two big re-elections in 1983 and 1987. Generally, her actions tended to match her rhetoric more closely than did Reagan's. She was more successful in making structural changes thanks to her large parliamentary majorities (which also enabled her to cut spending and taxes more in tandem), but also because she was more willing to confront her opponents. This led to her conflict with local government. With Labour's big defeats at the national level, local government was its last bastion; here Labour councils fought a guerrilla campaign, spending wildly and exceeding Whitehall's limits. As local government is a creature of Parliament, Thatcher had the power to bring it to heel, abolishing the unpopular "rates," or property tax, and replacing it with the per-capita "poll tax," or "community charge," in 1990.

The worst setback of the Thatcher years was the resurgence of inflation at decade's end.

The idea was to bring home to all voters the cost of their profligate local governments. But the tax, set by local authorities, often was much higher than expected, and most of the blame fell on Thatcher. Protesters rioted in Trafalgar Square and the *Financial Times* called it "the most disastrous political misjudgment in Britain's postwar history." Thatcher's increasingly autocratic style apparently contributed to this debacle, and thus to her subsequent fall. The Major government began to phase out the tax in the spring of 1991.

Tilting at the Welfare State

One striking parallel with the Reagan administration was the Thatcher government's inability to make more than peripheral reforms in the welfare state. In fact, high unemployment and an aging population helped to increase social welfare spending as a portion of the economy. Health, pensions, and other programs rose a good deal: health, 34 percent in real terms from 1978–79 to 1988–89; pensions and other benefits, 33 percent.

Among the trimming was elimination of certain smaller benefits (for example, earnings-related supplements for the unemployed, maternity benefits) and the indexation of others at below inflation. Child benefit was not indexed after 1987 (but indexing was restored by the Major government). Unemployment applicants were required actually to seek work.

Some efforts were made at reform, but dreams of tackling the welfare state ran head-on into the reality of widespread public support for government programs. In 1982 an internal paper outlining radical cuts was disclosed and Thatcher, under pressure from ministers and the opposition, had it withdrawn from the Cabinet. The government's ambitious review in 1984 of the State Earnings Related Pension Scheme in the end produced few savings. This experience parallels the 1982–83 Greenspan Commission on Social Security in the United States, which also shied away from significant benefit reforms, relying more on tax increases.

Much as Reagan was tarred with the anti-Social Security brush for his modest 1981 reform proposals, Thatcher found herself on the defensive, especially on the National Health Service. From early expressions of doubts about its affordability and efficiency, she came to boast of the additional resources she was putting into the NHS.

Following a 1988–89 review, she did make changes to improve services and reduce costs. Hospitals, until then granted a budget by the NHS based on costs, were given the option of generating their own income by offering billable services to the NHS. This allowed hospitals to compete and offer wider choice to patients throughout the country, not just their own area. Such opting out, which some senior hospital physicians are now admitting has improved services, followed an earlier reform under which general practitioners were paid by the NHS on the size of their patient group rather than the traditional salary. Thatcher's reforms became very controversial, and even after her third election, she dared not breathe a word of privatizing the NHS.

In another parallel with President Reagan, Thatcher was blamed for cutting programs, even though she often cut the rate of increase only and increased spending on many. Both Thatcher and Reagan received little credit for the success of their programs: their anti-inflation policies preserved the value of benefits and their growth policies guaranteed government's ability to maintain generous funding. Their leadership, ironically, restored faith in government, so people again look to the state for solutions. The survival of the welfare state, paradoxically, owes a good deal to their achievements.

How Lasting a Legacy?

The Thatcher legacy should prove more enduring than Reagan's, which currently is under vicious assault. True, she did not remake the Conservative Party in her own image; her successor, John Major, is a safe moderate, more of a consolidator than an innovator—he is hardly a charismatic politician. But his government is well to the right of pre-Thatcher Tory governments. It is extending some Thatcher policies, as in education and the Health Service, and would privatize British Rail and possibly British Coal should it win the next election, which will be held in April. Major also has adhered to Thatcher's unstinting anti-inflation policy as his highest priority, and has talked generally about reducing taxes further. On the other hand, without Thatcher's finger in the dike, domestic spending (as in the United States)

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

is rising sharply, in part reflecting renewed public demand for government services. He dropped the poll tax and is pursuing a compromise policy toward the other issue that brought down Thatcher, Britain's place in the emerging new Europe. Thatcher fears a more integrated EC with a common currency will erode Britain's sovereignty and impose statist policies; and she may be right in her criticism that Major's approach inevitably will ensnare Britain in a federal Europe.

Even if Labour wins the election, Britain will still bear Thatcher's imprint. In the past five years, Labour leader Neil Kinnock has responded to the drubbings inflicted by Thatcher by dropping his party's far-left program and presenting a moderate face to the electorate. The party says it would make changes in labor laws, but is pledged not to re-impose the closed shop and to retain Thatcher's reforms on members' ballots before strikes and some restrictions on picketing. It would not renationalize privatized industries except, if it could find the money, the utilities. If not, it would greatly increase utilities regulation. Reversing its earlier opposition, it also would retain the right of tenants to buy council houses.

Although Labour says it now accepts the market, it would restore some of the *dirigiste* policies of the Labour—and Tory—governments before 1979. But Labour also insists it would not increase government spending beyond that allowed by GDP growth (which would have to be robust to finance its £20-billion-plus plan). Its macroeconomic policies would be constrained, however, by Britain's membership in the exchange rate mechanism, which requires the government to maintain the value of the pound within a certain range, and later in the decade by the deficit limitations agreed at the EC Maastricht summit in December.

On taxes, Labour would raise the top rate from 40 percent to 50 percent. Coupled with its lifting of the current £20,280 salary ceiling on employees' National Insurance contributions, this would raise the effective top rate to 59 percent, a record peacetime tax increase.

Despite almost 13 years of Tory government, and the current severe economic downturn, the party is running roughly even with Labour in opinion polls. This in part is testimony to social changes in Britain, including the decline of the old working class, and to the radical transformation wrought by Thatcher. Her structural reforms have moved Britain's center rightward; she has fixed the bounds of today's playing field. By the force of her character, the 1979 election proved as far-reaching as the Liberal victory of 1906 (which ushered in an era of social reform) and the Labour triumph of 1945—even though she began as a minority in her own party and with a much smaller majority.

Britain still faces serious problems—continuing labor market rigidity and still-lagging productivity are responsible for high core inflation and unemployment. But Thatcher halted the decline and turned the nation around. She was "the one person who set her face against" the slide toward third-class status, wrote *The Economist*. She shifted the balance of the economy from the wealth-consuming public sector and big unions to the wealth-creating private sector, and restored the rule of law, bequeathing a much healthier society than the one she had found.

One million new families have become home-owners, thanks to Thatcher's sale of public housing to tenants.

Thatcher, like Reagan, held a lofty view of her work. As Reagan said in his farewell address, "The great rediscovery of the 1980s has been that...the moral way of government is the practical way." Or, in the words of Tennyson, which Thatcher quoted in 1979:

> We sailed wherever ship could sail,
> We founded many a mighty state,
> Pray God our greatness may not fail,
> Through craven fears of being great.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

In Sickness and in Health

The Medical Costs of Family Meltdown

Bryce J. Christensen

America is about to embark on a great debate about how to reduce the burden of rising medical costs on the economy, while at the same time providing coverage to the 36 million citizens who lack health insurance. Four main proposals are being discussed—a nationalized system on the model of Canada's, which would permit consumer choice among doctors but not among different kinds of insurance, and would ration care as well; the "pay or play" system, which would force employers either to offer health insurance, or to pay higher payroll taxes and transfer employees into an expanded Medicaid program; "managed care" systems, which would push Americans into pre-paid health maintenance organizations; and "consumer choice" plans, which would transfer health insurance tax benefits from employers to individuals, and so allow Americans to make more decisions about which insurance is best for their families.

An important criterion to consider in this debate is whether the different programs will have any impact on the structure of families themselves. The decline of the family in recent decades has contributed both to serious health problems and to rising health care expenditures, especially by government. Conversely, one of the best ways to improve Americans' health care would be to favor policies that strengthen families.

Divorcing for Medicaid

The explosion in health costs is well known. Total national health expenditures have risen from $75 billion in 1970 to $800 billion in 1991. Real per-capita spending on health care has climbed more than five times faster than productivity over the past two decades. Health care costs paid by government have risen from $28 billion in 1970 to $280 billion in 1990, and state spending for Medicaid has more than tripled in one decade, up from just $11 billion in 1980 to $34 billion in 1990.

What is often overlooked when examining these numbers is the impact the decline of the American family has on health care expenditures. The American divorce rate has risen more than 40 percent since 1970, by almost 250 percent since 1940. By extrapolating current trends, we may anticipate that about 40 percent of marriages formed since 1980 will end in divorce. On the other hand, the marriage rate among women ages 15 to 44 has dropped more than 35 percent since 1970; one American in eight now remains unmarried for life. Partly because of a drop in child-bearing among married women, the proportion of children born out of wedlock has climbed dramatically. In 1960, only one birth in 20 was illegitimate; today more than one-fourth of all births occur out of wedlock.

As growing numbers of marriages break up or fail to form in the first place, Americans are suffering from increased health problems and are less likely to have family members to provide or pay for care. All too often they have to resort to institutional care that is paid for by the government.

Equally alarming is the enormous strain rising health costs place on American families. There have been instances of families facing bankruptcy after paying for a serious illness who are considering filing for divorce so that the wife and children can go on welfare and receive Medicaid. Loss of health benefits after leaving Medicaid discourages unwed mothers from marrying or joining the work force.

Marriage as Therapy

A strong family life is not only good for your psyche, it's good for your health. Married men and women enjoy remarkably better health, on average, than unmarried peers, as numerous epidemiological studies have shown. Writing recently in *Social Science and Medicine,* Catherine K. Riessman and Naomi Gerstel note that compared with married men and women, the divorced and separated suffer much higher rates of disease, disability, mental neuroses, and mortality: "This pattern has been found for every age group (20 years and over), for both men and women, and for both whites and nonwhites." Divorce especially contributes to poor health. A 1985 study at the National Center for Health Services Research found that divorced women in the U.S. suffer from poorer health, even though the population of divorced women is "somewhat younger than the married."

Bryce J. Christensen *is editor of* The Family in America, *a publication of the Rockford Institute.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The link between marriage and good health holds true from Helena, Montana, to Helsinki, Finland. In two recent surveys of industrialized countries in Europe, North America, and Asia, demographers at Princeton University have discovered: "In developed countries, married persons of both sexes experience a marked mortality advantage relative to single individuals." They also found that "for the majority of countries [investigated]...as well as for both genders, the excess mortality of each unmarried state (relative to married persons) has increased over the past two to three decades."

What accounts for the relative healthiness of married men and women? Of course, chronically ill men and women typically do not marry in the first place. And statistical correlation between family status and healthiness does not establish a link of causation. That is, some of the conditions that imperil health—poverty, reckless behavior, poor housing, unemployment—also strain or prevent marriage. However, research increasingly shows that marriage itself fosters good health, while divorce and prolonged singleness expose the unmarried to health risks. Marriage and parenthood give men and women a sense of "meaning, obligation, [and] constraint," finds sociologist Debra Umberson, which reduces the likelihood that they will indulge in "health-compromising behaviors" such as excessive drinking, drug use, hazardous conduct, or disorderly living.

Better health habits alone, however, cannot explain the good health of married people. When researchers in this country and in Scandinavia have compared the health of married men and women with that of unmarried men and women with the same health habits and economic backgrounds, the results came back the same: married people enjoy better health, even more robust "cellular immune system control." Apparently, the emotional and psychological support found in marriage fortifies the body against illness. "Being divorced and a non-smoker is slightly less dangerous than smoking a pack or more a day and staying married," concludes Harold Morowitz of Yale University, adding facetiously that "if a man's marriage is driving him to heavy smoking, he has a delicate statistical decision to make."

Safeguarding Children

A successful marriage can safeguard the health not only of husband and wife but of their children as well. In a study published in 1985, researchers from Kent State University and the University of Akron found that American children of intact marriages enjoyed significantly better health than children of divorced and never-married parents. Scholars from Rutgers University likewise reported in 1988 that in two national surveys "single mothers report poorer overall physical health for their children" than married mothers.

In part, the poor health of children in single-parent households reflects their relative impoverishment. In 1988, 54 percent of all children living in female-headed households were living at or below the official poverty line. Fully 29 percent of children in female-headed households were in "deep poverty," defined as household income at 50 percent or less of the official poverty level. By comparison, only 10 percent of children in married-couple households were living below the official poverty line, and only 3 percent of children in married-couple households were living in deep poverty.

AP/Wide World Photos

Being divorced is only slightly less dangerous to his health.

But poverty is not the only explanation. A 1988 survey conducted by the Department of Health and Human Services found that, even after controlling for such factors as parental educational levels and socioeconomic status, children in single-parent families are 20 percent to 40 percent more likely to suffer health problems.

No Caregiver at Home

Not only do single Americans typically suffer from poorer health than married peers, they are more likely to require costly institutional care because they do not have spouses to care for them at home. As the divorce rate has climbed and the remarriage rate has fallen, a growing number of Americans have found themselves approaching their vulnerable later years alone.

In a two-year study at the University of Michigan, researchers monitored the health of 165 men and women, all aged 55 and over, after their hospitalization for various chronic conditions. During the two years of observation, the unmarried men and women spent "far larger fractions of time in the hospital (34.1 percent versus 16.0 percent)" than the married men and women suffering from similar illnesses.

As divorce-prone baby-boomers age, the absence of caring spouses may strain—if not overwhelm—the capacity of nursing homes and other long-term health care institutions. The high divorce rate, the low birth rate, and the rise in out-of-home employment among adult daughters points to a "demographic scenario" in which "elderly Americans long on life expectancy may find themselves short on care where it matters most—at home," says Peter Morrison of the RAND Corporation. The depressed birth rate will not only drive up future demand for costly institutional care, it will simultaneously reduce the number of taxpayers to pay for that care. Most demographers identify the trend toward fewer, later, and less stable marriages as a primary reason for a national fertility rate that has languished below the replacement level of 2.1 births per woman since the early 1970s. In 1988, the lifetime fertility rate stood at only 1.93 births per American woman, compared with 2.48 in 1970 and 3.65 in 1960. American Enterprise Institute

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

scholar Ben Wattenberg anticipates that this "birth dearth" could bankrupt the Social Security system if (as he expects) government officials combine the Social Security trust and the Medicare trust fund. Already we are seeing an enormous increase in government outlays for such care. Medicaid payments for long-term care for those who are not mentally retarded increased from $4 billion in 1973 to $18 billion in 1990.

Even now, while the baby-boom generation is still relatively young, the decay of family life is already imposing huge burdens on government health care programs. According to the Office of the Assistant Secretary for Planning and Evaluation of the U.S. Department of Health and Human Services, over half (54 percent) of all recipients of Medicaid in 1991 lived in households headed by an adult who had never married or one whose marriage had ended in divorce or separation. By comparison, only 25 percent of the total American population now lives in households headed by never-married or divorced adults. In 1986, the Health Care Financing Administration compared the overall characteristics of "high users" of inpatient hospital care with those of "high users" whose care was paid for by Medicaid. Predictably, high users whose expenses were paid for by Medicaid were three times as likely to be divorced or separated.

Children in single-parent families are 20 percent to 40 percent more likely to suffer health problems.

Maternity Cost-Shuffling

The burgeoning divorce and illegitimacy rates impose other government medical costs as well. In the maternity ward, it is Medicaid that generally pays the birth costs of children of never-married mothers. Studies at Chicago's Cook County Medical Center and elsewhere have shown that children born to unmarried parents are especially likely to be born prematurely, often with conditions requiring surgery, mechanical respirators, isolation incubators, or other costly medical care paid for by the taxpayer—or, through cost-shifting, by other patients.

Because of their relative impoverishment, single mothers usually do not have private health insurance for themselves and their children. Among families having household incomes of less than $14,000, only 35 percent had private health insurance in 1989, compared with 71 percent of families with household incomes of $14,000–$29,000 and 88 percent of families with household incomes of $25,000–$34,999. Female-headed households living in "deep poverty" are especially vulnerable. Among those uninsured Americans not covered by Medicaid, 45 percent were in single-parent families or living without a spouse or parent.

Strengthening the Family Circle

As Americans debate future policy for health care, we need to remember the abiding importance of the family. Policies that rely on government programs and on employers—but not on families—will likely exacerbate the current retreat from marriage and family life, thus compounding the long-term difficulties of providing health care for many Americans. In assessing the four major options now under consideration, policy-makers may take it as axiomatic that the family grows stronger by bearing responsibilities and exercising freedom; government weakens the family by taking over its responsibilities and abridging its freedom. With good reason, anthropologists Glynn Custred and Andrei Simic warn of the "circular relationships...in which the state is increasingly called upon to fill the void created by the erosion of the family's primary functions, and in so doing further aggravates the situation."

Of the four health care strategies now before Congress, only the consumer-choice proposal appears likely to foster family autonomy and strength. Some families—especially young families with new mortgages—might choose relatively inexpensive health care coverage that would shield them against catastrophes but would require them to pay routine medical expenses out of pocket. Families with strong networks of extended kin might purchase relatively little medical coverage for future long-term care, while families without such networks might choose more costly coverage because of anticipated costs for institutional care. Under consumer choice, many young couples would regard maternity insurance as essential; many older (and some younger) couples would consider it unnecessary. In short, a consumer-choice strategy would allow parents and spouses to make choices that reflect their circumstances and their commitments. Moreover, under such a strategy, immigrant associations, churches, and other organizations whose members had strong families could offer their own health insurance policies—at a discount to current premiums.

In the other strategies under scrutiny, American families would bear fewer responsibilities for health care but would also exercise less freedom in making choices. Nationalized health care would impose the most egregious abridgment of family autonomy, since it would turn all Americans into clients of one paternalistic medical insurer. Even the proposals for "pay or play" and for "managed care" would significantly reduce family responsibility for health care while simultaneously reducing the range of options for meeting that responsibility. To the degree that government, health maintenance organizations, or employers take health-care decisions out of the hands of parents, spouses, and adult children, they deprive family ties of substance and discourage the formation of permanent domestic commitments.

Regardless of the education or skill of its designers, any plan for providing health care deserves skeptical assessment from American leaders and voters if it ignores or undermines the family. The challenge of providing health care requires more than a short-term fix or a campaign slogan. It requires the far-sighted vision that recognizes the perduring importance of the family. ☎

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Morning After in America

The Austrian View of the Recession

Llewellyn H. Rockwell Jr.

What causes recessions or, for that matter, recoveries? Irving Kristol recently said we can't know because there's "no theory of what we call the business cycle, no theory worthy of the name." He professed a "gnawing uncertainty about the future of our market economy until our economists can reassure me that at least they have got the theory of it right, so that if politics and politicians then proceed to mess things up, I'll know who, in good conscience, I can blame."

Mr. Kristol is right about the confusion among economists. Unlike price controls and trade restrictions, where most economists agree—they're harmful—there is no consensus on business cycles. Debates rage in scholarly journals between contending theories. But in this debate, one theory is too often overlooked: the "monetary-malinvestment" theory of the Austrian School. Only the Austrian School (named for the nationality of its earliest proponents) offers a theory that makes sense, fits with experience, and explains the current cycle.

In broad outline, the Austrian theory argues that business cycles are not inherent in market capitalism, but are imposed on the economy by the central bank. When the central bank expands credit, it lowers interest rates below their market level, leading to overinvestment (or malinvestment) in the interest-rate sensitive areas of the economy, which creates an artificial boom. When the central bank stops expanding credit, mistaken investments are revealed as such, and the boom turns into a bust. Not all downturns or upturns in the economy are cyclical. Increases in taxes or regulation, for example, can have the economy-wide effect of depressing production. And reduced taxes and regulation can give a stagnant economy a boost. But these are simply shifts in production growing out of institutional changes. They do not constitute the recurring cycle of booms and busts from which we suffer.

Marx's Systemic Crises

The existence of business cycles has not always been obvious to economists. Adam Smith and his contemporaries did not theorize about cycles because they did not realize they existed, probably because they were not as regular or as pronounced as today's. As economic historian Joseph Schumpeter showed, it was not until the spread of bank credit at the end of the 18th century and the beginning of the 19th that economists began thinking about business cycles.

Thomas Malthus at the turn of the 19th century was the first classical economist to write about cycles, attributing them to bouts of underconsumption and oversaving. His successor David Ricardo more accurately placed the blame on imbalances in international gold flows. The lesser known James Pennington in England and the Jacksonians in America also saw the monetary nature of business cycles.

Yet the classical economists had no entirely persuasive theory. What remained a mystery in their framework was the widespread and simultaneous entrepreneurial error that occurred in an economic downturn. It is normal for some capitalists to make poor forecasts in their investing, but in economic downturns these errors are magnified and more common. Neither Malthus nor Ricardo could account for the seeming collapse of business judgment.

In light of this, Karl Marx argued that cycles were one of the many serious, inherent flaws in the capitalist system. The busts were systemic crises that would get worse and worse until capitalism itself crumbled. Only socialism could prevent business cycles. In an odd way, it did. The Soviet Union had no business cycles, since it had no real credit structure, prices, or markets. Instead, it suffered a 72-year-long depression punctuated by bouts of chaotic industrialization and forced famine.

Mises and Malinvestment

Not until 1912, with the publication of Ludwig von Mises' *Theory of Money and Credit*, was there an entirely satisfactory explanation of cycles. Mises elaborated on the theory in later works, and Friedrich Hayek, a student of Mises, formalized and modeled it in the 1920s, for which he later won the Nobel Prize.

The Austrian School argues that there is a distinction between authentic economic growth—which is a product

Llewellyn H. Rockwell Jr. *is founder and president of the Ludwig von Mises Institute at Auburn University.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

of increased savings, better technology, and successful investment—and artificial booms generated by central-bank credit expansion. In a free market, the normal state of affairs is sustained economic growth; classical economist Jean-Baptiste Say observed that supply and demand move toward market equilibrium, as do the proportions of consumption and investment.

This natural order is distorted by cycles, which occur only when the central bank expands credit, lowering interest rates below the market level. This causes overinvestment in the capital goods sector that cannot be sustained by the existing rate of saving. The bust comes when the central bank stops or slows the credit expansion to temper the price increases that inevitably follow an easy money policy.

Because Austrians see booms as destructive, they look upon recessions with something like relief.

Capital goods—from industrial robots to office buildings—represent investments in processes used over time to produce consumer goods. Because of the time element, they are especially interest-rate sensitive. So when the central bank expands credit, lowering interest rates, the capital sector booms, as do the stock and bond markets that represent titles to capital. And they do so out of all proportion to the rest of the economy. Consumer goods and services are of course affected by harmful central bank policies, but because investment decisions in this sector are on a shorter time horizon, the damage isn't as severe.

Chain-Letter Investors

In a free market, most firms are profitable most of the time. But central-bank expansion seduces long-term investors into believing that the savings will be there later to purchase their product at the prices they anticipate. The boom is synthetic, for there has been no increase in savings, the only source of an authentic decline in interest rates or of legitimate credit expansion.

Come the bust, there are not enough savings to validate the excessive capital goods investments of the boom. At this point, capitalists must shrink their enterprises or go broke. There are layoffs, plant closures, and bankruptcies. The malinvestments are washed out of the economy, either quickly if there is no government intervention, or slowly if there is.

The central bank can keep the boom going by expanding more and more, but only at the risk of hyperinflation. To avoid the threat of monetary breakdown, it cuts off the supply of new credit. The bust, in other words, is an inevitable consequence of the boom.

Would "rational expectations" or even "adaptive expectations" negate the effects of the business cycle? If businessmen knew that interest rates were artificially low, why would they take the bait? The real question is: why wouldn't they? Builders and investors, hardly a risk-averse group, assume they will make their profits during the boom and get out before the bust. Economist Roger Garrison uses the analogy of the chain letter: the author of the letter, and those taking part at an early stage, may know that the scheme will later collapse, but they also know that they can profit from it. Similarly, the boom can continue for quite a long time and capital-sector borrowers can still make large net profits, even if they are caught in a later bust. Capitalists' micro-expectations of profit diverge from their macro-expectations of an eventual bust.

The Austrian theory is unique in starting its analysis with the boom. If prosperity is not artificially stimulated, there will be no bust. Credit expansion is healthy if its source is growing savings (or, in the case of the gold standard, more gold discoveries). But if new credit is created by the central bank and injected via the commercial banks, Mises and the Austrians see only trouble ahead.

Because Austrians see booms as destructive, they look upon recessions with something like relief. It is as if their alcoholic brother-in-law stops drinking. The discomfort he feels while sobering up is not only a necessary consequence of his behavior, but a sign that he is straightening himself out.

Keynes Unable

The Austrian theory was widely debated on the Continent and in England in the 1920s and 1930s, and Mises and Hayek set up a center in Vienna to study cycles. But because it unfashionably saw government intervention as the cause of the business cycle, the Austrian theory was branded as reactionary. In the midst of a worldwide depression, left-wing theories positing fundamental defects in the free market won out.

John Maynard Keynes was the major beneficiary of this anti-capitalist bias. Like Marx, he saw business cycles as inherent in capitalism, but unlike Marx, thought that wise government management could correct them. To Keynes, the market (unlike the government) was irrational. Periodic waves of "animal spirits" would cause stocks to plummet, consumers to stop buying, and businessmen to stop expanding, bringing on a recession that only the government could cure.

Keynes saw the price system as defective, and therefore unable to do its job during a recession. Wages, for example, were "sticky"; that is, they would not adjust as easily as the price of eggs. If workers—bolstered by the prospect of unemployment payments—demanded their pre-recession wages, they were in effect demanding a raise, since their labor was now worth less. The Keynesian answer was the "money illusion": inflation that secretly eroded wages. Workers' nominal wages would stay the same while their real wages fell.

Inflation could also be used to help finance new expenditures by government, which Keynes saw as necessary to boost overall spending. This desire to enhance aggregate demand, which he saw as essential to recovery,

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Photofest

Americans are paying today, according to the Austrians, for the easy money and artificially low interest rates of the '80s.

led him to overthrow the historic opposition of economists to budget deficits, and to argue that they help bring about recovery. In short, Keynes recommended an artificial boom to cure the effects of the previous artificial boom, ignoring the bad investments that needed to be washed out of the system.

While Keynes and his disciples convinced almost everyone that they alone knew how to remedy the depression, they were able to survive the failure of their theory, as the depression dragged on and on, because they were serving the desires of politicians for bigger government.

The policies Keynes advocated—big spending, large deficits, high taxes, and giant public works projects—were already the practice of almost every industrial country. Roosevelt's New Deal, which Keynes praised highly, began three years before the economist's *General Theory* was published. In the introduction to the German edition of the book, Keynes applauded Hitler's economic policies as well. But they, too, antedated his book.

Explaining the Great Depression

Since that time, many studies have shown that the 1929 stock market crash and following depression confirm not Keynes, but the Austrian theory. For example, Paul Johnson in *Modern Times* finds the Austrian theory to be the most persuasive account, and cites *America's Great Depression* by Mises' student Murray N. Rothbard. The prosperity of the 1920s, says Johnson, was sustained by deliberate expansion of the money supply, made possible by "the pre-war creation of the Federal Reserve Bank system." No money printing was involved. The currency in U.S. circulation was about the same from the early 1920s until the end of the boom in 1929. But as Rothbard had shown, the expansion of total money supply, in money substitutes and credit, was huge—up 62 percent in eight years.

The Federal Reserve's stated goal was to provide credit "at rates of interest low enough to stimulate, protect, and prosper all kinds of legitimate business." Even though this expansionist policy did not result in a general rise in prices, it damaged the economy at a deeper level. After the credit expansion ended in 1928, the economy tumbled. But as Johnson notes, "all this was to be expected; it was healthy; it ought to have been welcomed." Recessions and depressions "sorted out the sheep from the goats, liquidated the unhealthy elements in the economy and turned out the parasites."

The Austrian explanation of the Great Depression is that this sorting-out process was unnecessarily prolonged. As Rothbard, Lionel Robbins, Benjamin Anderson, and many others have pointed out, the extraordinary interventions in the market by both Hoover and Roosevelt—from cartelizing industry and the labor force to erecting trade barriers—transformed what should have been a year-long bust into a decade-long nightmare.

The panics of the 19th century tell a similar story, although without a powerful central bank to bail out irresponsible and overextended commercial banks, the troubles were contained. The Federal Reserve System, created in 1913, was supposed to eliminate panics. Instead, it depreciated the dollar by 99 percent and turned short-term problems into the full-scale inflationary recessions we know so well today.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Errors of Monetarism

Most economists have not criticized or even noticed the credit expansion of the 1920s that led to the 1930s debacle. Milton Friedman and the monetarists, for example, start their analysis with the downturn itself, and do not examine what preceded it. Friedman blames the Federal Reserve, not for expanding credit in the 1920s, but for failing to funnel even more credit to the banks once the Depression began. But he fails to examine what made the banks vulnerable in the first place.

The failure of the monetarists to recognize the fundamental cause of the business cycle produces a policy blind spot as well: they seek to produce price stability through central banking with a steady increase in money and credit equal to the growth rate of the economy. If the economy grows at 3 percent a year, then so should the money supply.

Stable prices are no nirvana, however. Prices were stable throughout the 1920s even as Fed expansionism unbalanced the economy. Without that expansion, given the productivity of a free market, prices would have fallen, as they did during the most laissez-faire and therefore prosperous years of the 19th century. Falling prices are the natural state of the market, absent central banking. The entire economy would be like today's computer industry—falling prices and increasing quality.

The central bank should have no role in the recovery except to allow interest rates to achieve their market level.

Most important, the monetarists' small, steady rate of increase in the money supply distorts the economy just as surely as a large, erratic rate. This is because the increase in money enters the economy from the central bank through the credit markets, lowering interest rates below their market level. This new money sends misleading signals to capitalists, lengthening their time horizons and causing "injection effects"—over-investment in the capital goods sector that creates the boom phase of the business cycle. The Austrian School rejects monetarist central-bank policies in favor of a self-regulating monetary and banking system that would not distort the signaling function of the interest rate.

The 1980s' Boom

The Austrian School argues for other laissez-faire policies: for example, deregulation, privatization, decentralization, and massive tax and budget cuts. Yet despite their enthusiasm for free markets, Austrians do not share the conventional conservative wisdom about the 1980s. Some of the data from the period look impressive—job creation, economic growth, low price inflation—but as in the 1920s, severe problems were being created beneath the surface.

The most obvious similarity to the 1920s is the expansion of credit. Even accounting for the changes in financial regulation, which make money supply numbers more difficult to trust, much less interpret, the 1980s were awash in cheap money. From recession to recession (1981–1990), M1 (currency and coin plus checking deposits) increased 89 percent, while M2 (M1 plus savings deposits) increased 85 percent.

Impatient with the pace of recovery, the Fed expanded dramatically after the recession of 1981–82, with M2 growth hitting 12 percent in 1983. Reductions in the rate of growth began soon after, slowing to 8.6 percent, and by 1984, GNP growth had slowed as well, threatening another recession. The Fed switched gears, and in 1985–86, M2 shot up to 9.4 percent in 1986 (with M1's growth jumping from 5.9 percent in 1984 to 16.8 percent in 1986). This rapid increase was halted when the Fed joined the Reagan administration's efforts to halt the two-year international decline of the dollar, a result of previous expansion. From 1986 to 1987, M2 growth fell from 9.4 percent to 3.5 percent. The outcome was the stock market crash of 1987. M2 growth bobbed up and down at about 5 percent until 1990, when it again collapsed, bringing on the newest recession. Thus we can chart the boom and bust of the business cycle from the monetary high-water mark of 12 percent in 1983 to the low mark of 1.2 percent in the last quarter of 1991.

The discount rate tells the same story. It was lowered from a high of 13.4 percent in 1981 to 8.5 percent in 1983, a clear sign of central-bank credit expansion. The rate clicked up slightly in 1984 prior to the threatened recession, but fell again steadily until 1988. In 1991, the Federal Reserve repeated the same errors in driving the discount rate lower before malinvestments had fully washed out of the economy.

Real growth took place in many areas of the economy in the 1980s, especially in high technology, but had the Fed continued its expansionist course of 1985–87, we would have hyperinflation today. Instead, we have the recession.

Real Estate Bust

All through the '80s, James Grant, editor of *Grant's Interest Rate Observer*, warned that only a credit expansion could account for the extent of the growth—not cuts in marginal tax rates, not minor deregulation, and certainly not non-existent cuts in government spending.

Grant, a student of Austrian School cycle theory, recently wrote that in the United States over the past 100 years, "credit has become democratized. To simplify only a little, in some early expansions, almost nobody could get a loan. In the 1980s, everybody could." The "liberalizing tendencies of the Reagan prosperity," superimposed on the century-long trend toward easier credit, resulted in the "greatest expansion of credit in American annals."

"More cars were financed, more companies leveraged, more office buildings constructed, and more millionaires fabricated than in any other cycle on record." It was an "epic boom" but "with this modern difference. Mainly, depositors did not run on illiquid or even insolvent banks," thanks to the Federal Deposit Insurance Cor-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

poration (FDIC), the Federal Savings and Loan Insurance Corporation (FSLIC), and the "too-big-to-fail" doctrine. The "expansion was prolonged because speculative-grade lending, especially against real estate, went unchecked."

In the 1980s, therefore, there was no forced contraction of excessive loans. The real estate industry exploded in prices and returns far beyond what savings could support, but the high returns encouraged further loans on the expectation that returns would never stop rising. When the credit contraction hit in 1990, real estate was devastated. Developers and landlords went bust, as did many of their S&Ls. The effects rippled throughout the economy, with less demand for a host of products and professions.

There are things that can hurt an economy—George Bush's heavy new taxes and regulations, for example. And Ronald Reagan's marginal tax rate reductions and financial deregulation contributed to the 1980s' growth. But none of this can account for the 1980s' boom, the definite course it took, nor the depth of the present recession. Austrian theory, on the other hand, takes a longer view, pointing out that the recent cycle follows the same course as every other cycle since the central-banking era began.

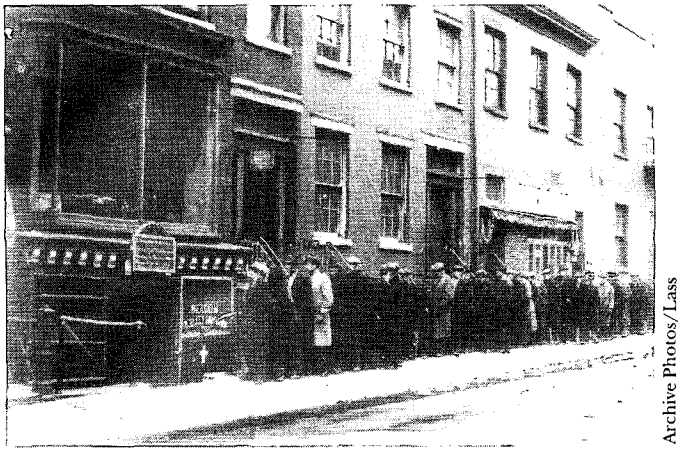
The Austrian Way Out

As to an economic recovery, there is no quick way to bring one about without causing damage for the future. The answer does not lie in stimulating consumer demand. When Bush bought socks at J. C. Penney's, or called on Americans to buy something, "a house or a refrigerator," he showed himself a devotee of Keynesian doctrine. On the same basis, he speeded up federal spending, pressured the Federal Reserve to lower interest rates, and encouraged consumers and businesses to go further into debt.

Liberal economists and Democratic presidential candidates are no better, seeking to cure the recession with government "investment," that is, more spending to be funded by more taxes. Government spending, however, is rarely genuine "investment" but rather consumption spending by politicians and bureaucrats, and raising taxes can do no good. Diverting more money out of the productive private sector and into the anti-productive public sector only hurts the economy.

Neither will the Federal Reserve's interest rate cuts bring the economy back into balance. For one thing, they mistake the cause for the cure. For another, the Fed is not always as in control as it would like us to think. Instead of stimulating more borrowing by skittish businessmen or skittish consumers from skittish banks, the new credit has circumvented a shaky banking system and gone into currency. And investors unwilling to risk new business starts are putting their money into short-term government securities.

Arthur Burns, as chairman of the Federal Reserve, was widely criticized for giving into pressure from Richard Nixon and expanding the money supply to ensure a Nixon victory in 1972. This was not an isolated example of a Fed chairman seeking to maximize his president's reelection chances. A study by Stephen E. Haynes and Joe Stone demonstrated a pattern of "strong four-year cycles in unemployment and inflation with peaks and troughs consistent with the four-year election cycle" from 1951 to 1980. The interest-rate cuts of current Fed chairman Alan Greenspan seem to be following a similar pattern.



Archive Photos/Lass

Austrians attribute the Great Depression to the credit expansion of the '20s.

The Burns–Nixon expansion led to the inflationary debacle of the Ford years. We can't know when the Greenspan credit expansion will have its effect, but we can know that it will cause another business cycle.

To get out of the present recession without causing a future one, we need to slash federal spending, taxes, and regulation—economic, racial, and environmental—freeing the private economy to produce again. The central bank should have no role in the recovery process except to allow interest rates to achieve their market level. "There is no use in interfering by means of a new credit expansion with the process of readjustment," Mises wrote in *Human Action*. "This would at best only interrupt, disturb, and prolong the curative process of the depression, if not bring about a new boom with all its inevitable consequences."

Abolish Central Banking

The Marxists were wrong: we shouldn't overthrow capitalism to get rid of business cycles. The Keynesians were wrong: government management only makes things worse. And the Monetarists were wrong: stable prices courtesy of the central bank produce underlying instabilities. The Austrians, however, are right. Business cycles can be eliminated, but only with sweeping reforms.

To end business cycles, we must scrap the institutional barriers to a free market in money and banking—bailouts, deposit insurance, and central banking—and establish sound money, market-set interest rates, and a decentralized monetary regime resistant to political meddling. Without central bank intervention, we would have to brace ourselves for a short, painful period of allowing malinvestments to be washed out of the system. Politics may work against such an approach, but it is the only way to insure that the next recovery starts on a sound foundation.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

WHO'S THE LAISSEZ-FAIREST OF THEM ALL?

The Tradition of Natural Rights in American Law

HADLEY ARKES

In the first case to elicit opinions from the Supreme Court, Justice James Wilson explained what was truly novel in the new American republic. The law in England had begun with the sovereign; it was built on the principle "that all human law must be prescribed by a *superior.*" But the law, in America, would begin "with another principle, very different in its nature and operations." Jurisprudence would find, here, an entirely different ground: "[L]aws derived from the pure source of equality and justice must be founded on the *consent* of those, whose obedience they require. The *sovereign,* when traced to his source, must be found in the *man*" (*Chisholm* v. *Georgia,* 1793).

Wilson was restating the Founders' understanding that certain rights spring from the nature of human beings, and that these rights are the same in all places where human nature remains the same. In the name of natural rights, the American Founders fought the Revolution and wrote the Constitution. But in our own time the principles of natural rights have been derided, if not totally forgotten, by most lawyers. Indeed tremors were set off last year in the Senate Committee on the Judiciary, as it faced in Clarence Thomas a nominee for the Supreme Court who took seriously the tradition of natural rights.

A Common Misunderstanding

This prospect set off special alarms in the chairman of the committee, that judge of judges, Senator Joseph Biden (D–Delaware). In Biden's reckoning, the return of natural law would imperil the whole structure of legislation put in place over the years to secure the public safety. Judges fired again by these ancient convictions would threaten "many of the most important laws enacted in this century: laws protecting the environment, our water, and our air; laws regulating child-care and senior citizen facilities."

As Biden acknowledged, laws of this kind did limit freedom: "They limit the freedom to contract. They limit the freedom to use one's property exactly as they would wish. They limit the freedom to pollute....Or, as we saw in North Carolina recently, they limit the freedom of a factory worker to lock his employees into a building where 25 of them perished in a fire." The translation, for Biden, was complete: If we had judges again like the great exponents of natural rights, the safety of workers would be imperiled, and there would be more people dying in chicken plants.

Biden identified the cause of natural rights with the conservative judges who restrained unions and struck down laws on the minimum wage in the earlier part of this century, and resisted Roosevelt and the New Deal in the 1930s. These were the judges cast by liberal writers as the Darth Vaders of the American bench: Stephen J. Field, appointed by Lincoln (and serving from 1863 to 1897); Rufus Peckham (1895–1909), author of that widely vilified opinion in *Lochner* v. *New York,* where the Court struck down a law limiting the hours of work in bakeries; and the scholarly George Sutherland (1922–1938), one of the legendary "Four Horsemen" of the Court who had checked the New Deal.

They have become known as the "laissez-faire" judges, who would brook no tinkering by an officious law with the rights of a businessman in the ordering of his own private property. In Biden's mind, their disposition was to let the economy alone, without the heavy hand of regulation or such sentimental notions as "social legislation" and the "public good."

Wrongful Uses of Property

This portrait of the judges is familiar, and it has been accepted readily by commentators on the right as well as the left. But it is also, irredeemably, false. If we scan the record of the conservative judges from the end of the 19th century to the New Deal, it is hard to find a case where they failed to sustain regulations of business that were aimed at the safety of workers and the health of the public. The grand expounders of natural rights did have an expansive notion of liberty, and yet the critics seem to forget that the understanding of natural rights

HADLEY ARKES *is the Edward Ney Professor of Jurisprudence and American Institutions at Amherst College and a Bradley Scholar at The Heritage Foundation. His most recent books are* Beyond the Constitution *(Princeton, 1990) and* First Things *(Princeton, 1986).*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

encompassed the rights of ordinary persons to make their livings even at rather common, prosaic work. As Rufus Peckham wrote in *Allgeyer* v. *Louisiana* in 1897:

> The liberty mentioned in [the Fourteenth] Amendment means not only the right of the citizen to be free from the mere physical restraint of his person, as by incarceration, but the term is deemed to embrace the right of the citizen to be free in the enjoyment of all his faculties; to be free to use them in all lawful ways; to live and work where he will; to earn his livelihood by any lawful calling.

In that same opinion, Peckham registered his conviction that this freedom to follow one of the common occupations of life fell into the class of those "unalienable" or "natural" rights of man, the rights that were proclaimed in the Declaration of Independence. Chairman Biden had things half-right: The connection to natural rights was critical, but the relation was just the opposite of what he thought it to be. It was precisely because the judges understood the moral ground for the rights of property that they understood, with the same precision, the moral limits on the uses of property. And for that reason they suffered no inhibitions in sustaining a host of measures that would restrain the wrongful uses of property.

To look again at those judges, and understand the design of their law, is to draw ourselves back to the things we used to know about the moral case for a free economy. And it is to teach ourselves again what conservatives used to know about the moral grounds of the law.

In Locke's Steps

The ownership of property began, as John Locke taught so forcefully, with the ownership of ourselves. We had a claim to the fruits of our own labor, or the work produced with our own hands, only if we were the owners of our own hands. We would not be the owners of our hands if we were slaves, and our hands belonged to someone else. But at the same time, as Locke also taught, nothing in our ownership of ourselves, or other things, could possibly establish a "right to do a wrong," to others, or even to ourselves.

These themes came together, in the clearest way, among the judges like Stephen Field and John Harlan who had come through the Civil War. The Republicans had abolished slavery through the Thirteenth Amendment, and reconstituted the political order on terms that acknowledged more explicitly the founding of the republic on "natural rights." Lincoln remarked that the black man, in his right not to be ruled without his consent and his "right to eat the bread, without leave of anybody else, which his own hand earns,...is my equal and...the equal of every living man."

The judges who had come out of the antislavery movement began with this premise of natural freedom: that human beings were by nature the owners of their own labor. Justice Harlan pointed out, in one of the early cases on unions, that it was not within the authority or the functions of government, "at least in the absence of contract between the parties...to compel any person, against his will, to perform personal services for another." Every person had a natural right "to sell his labor upon such terms as he deems proper," and a right "to quit the service of the employer for whatever reason" (*Adair* v. *United States*, 1908).

AP/Wide World Photos

Senator Biden can relax. The natural rights judges repeatedly sustained regulations of business aimed at the safety of workers and public health.

To begin with any other premise was to suggest that the labor of a man belonged to an employer or to the state. Those premises had to be ruled out by anyone who took seriously the premise of natural freedom. And that is why the Republican judges, in the aftermath of the Civil War, were sensitive to any arrangements that could reinvent those denials of natural freedom, even in the guise of something new and "progressive." The freedom to join a union, or any other legitimate association, was implicit in the natural freedom of any man. But that freedom to join a union could not create a power to bar another man from a job he was willing to accept, merely because he was not a member of a union. One federal judge found it "preposterous" that unions should replace slave-holders and "attempt to issue orders that free men are bound to obey" (*In re Higgins*, 1886).

Freedom of Contract

There was also a critical symmetry between the freedom of the worker and the freedom of the employer. For clearly, the employer was no less of a natural man than the employee. As Justice Harlan expressed the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

point, "The right of a person to sell his labor upon such terms as he deems proper is, in its essence, the same as the right of the purchaser of labor to prescribe the conditions upon which he will accept such labor from the person offering to sell it." The worker may have a right to join a union or any other association, and the employer would be free to consider whether he would wish to preserve his association with a man who held memberships, say, in a union, a church, or the Ku Klux Klan. But the employer could also decide, in the same way, that he would promote a union, and hire only the members of a union. And that, too, would come within his proper freedom, even though it would put a certain pressure on workers to join that union.

But the freedom of employers and workers would both be abridged if the power of law were annexed to the demands of unions—if employment were made dependent on membership in a union, quite apart from the wishes of the employer and the worker. The judges who were sensitive to natural rights were attuned, rather finely, to that difference. And they recognized the same wrong to be in place whenever the law was used in comparable ways to interfere with the freedom of a man to take up employment at legitimate work. Those restrictions could take the form of laws that presumed to fix the minimum wages or set the maximum hours of employment. Or they could take the form of licensing or regulation that created monopolies or special franchises. In either case, people were barred by law from entering a business or making their living at legitimate work. The regulations that imposed these restrictions were put forth with the most high-minded labels, but to judges like Stephen Field, they were drawn from the most retrograde premises. In the name of social uplift, they threatened to strike at the premises of natural rights and the movement toward free labor begun with the American Revolution and advanced by the Civil War.

It was precisely because the judges understood the rights of property that they understood the limits on the uses of property.

Legitimate Police Powers

Field had the occasion to pronounce on these points in the *Slaughter-House cases* (1873), the first set of cases that tested the Civil War amendments to the Constitution. With the ratification of the Fourteenth Amendment in 1868, the federal government had a new lever for intervening within the states and protecting people from legislation, at the local level, that would "deprive any person of life, liberty, or property without due process of law." But in the *Slaughter-House cases* the Court would decline to fashion this kind of lever. It would not move to the defense of people who were simply seeking to make their living at a rather unglamorous trade. And that holding back, from a want of conviction or a want of understanding, brought forth a magisterial dissent from Stephen Field.

The cases involved a regulation in Louisiana that concentrated in one licensed slaughter-house the responsibility to inspect and slaughter all meat brought into New Orleans and its environs. The measure was put forth as an exercise of the traditional "police powers" of the state. Under those powers, the local government would exercise a broad mandate to act for the "health, welfare, and morals" of the local population. That ancient mandate ran back beyond the Constitution, to the foundations of the *polis* itself and the first understandings about the business of government. And when the law was seen in that traditional cast, most of the judges were willing to uphold the regulation in Louisiana. They might not have regarded the regulation as wise, but they were willing to treat it on the terms on which it was put forward, as a measure aimed to protect the health and safety of the public.

For his own part, Justice Field had no quarrel with licensing laws that sought to protect the safety of the public. But he found no trivial restriction of freedom in the laws that created monopolies or barred the entry of people into the most common trades. Field did not challenge the claim of a state to insure sanitary conditions in slaughter-houses. But it strained credulity to claim that this interest of the state required that all meat be passed through one set of slaughter-houses for a population spread through three parishes (counties) and 1,154 square miles, and that no other butcher should be suffered to remain in business.

As Field argued, the legitimate concerns of the police powers were satisfied by two provisions: the requirement that animals be landed and slaughtered below the City of New Orleans, and that the animals be inspected before they were slaughtered. Beyond those provisions, a monopoly offered nothing to promote the public health. It was one thing, said Field, to grant a monopoly to an inventor to be the sole producer or vendor of his own invention. For the government merely secures to the inventor "the temporary enjoyment of that which, without him, would not have existed." But there was a dramatic difference between a case of that kind and a monopoly to engage in "one of the ordinary trades or callings of life." The arrangement suggested an altogether different meaning: a factitious monopoly, created by the state, as a means of conferring privileges. And those privileges would be purchased at a cost of denying to other people the freedom to enter the same lawful occupation. This freedom to work at an ordinary trade, Field regarded as "a right appertaining solely to the individual." It was one of those "natural rights" that it was the mission of a free government to secure.

The Right to Work

Field summoned to his support the edict issued in 1776 by Louis XVI of France as he completed the work

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

of removing all monopolies of trade sponsored by the state. The edict, written by the finance minister Turgot, explained that the right to work at an ordinary calling, without the barriers of a legal monopoly, was simply a species of "natural rights":

> [S]ome persons asserted that the right to work was a royal privilege which the king might sell, and that his subjects were bound to purchase from him. We hasten to correct this error and to repel the conclusion. God in giving to man wants and desires rendering labor necessary for their satisfaction, conferred the right to labor upon all men, and this property is the first, most sacred, and imprescriptible of all....[Therefore, he regarded it] as the first duty of his justice, and the worthiest act of benevolence, to free his subjects from any restrictions upon this inalienable right of humanity.

When the Founders had spoken of "unalienable rights," Field understood that they had meant to sweep away all arbitrary restrictions by the government. He was convinced that the original clause on the "privileges and immunities" of citizens (in Article IV, Section 2, of the Constitution) would have forbidden a state from creating monopolies in certain trades or manufactures confined to its own citizens, and from excluding citizens from other states. "She could not confer, for example, upon any of her citizens the sole right to manufacture shoes, or boots, or silk, or the sole right to sell those articles in the state so as to exclude non-resident citizens from engaging in a similar manufacture or sale." But now, with the passage of the Fourteenth Amendment, Field was clear that the federal government was given a more explicit empowerment to act as the national guarantor of these rights *within* the states.

Rebutting a Facile Doctrine

Field issued another ringing dissent three years later when his colleagues failed again, conspicuously, to make use of this new lever. In *Munn* v. *Illinois*, the Court upheld a law in Illinois that set the prices charged to farmers for the storage of grain in elevators. Chief Justice Morrison Waite offered the most serviceable slogan, which would become in turn the most facile defense for almost any law that imposed restrictions on the way people made their livings: "Property [becomes] clothed with a public interest when used in a manner to make it of public consequence, and affect the community at large."

Justice Field argued in rebuttal that this doctrine would virtually dissolve the concept of "private property"—and therefore it would nullify all protections of property mentioned in the Constitution. For in the construction of the Court, property would become "clothed with a public interest" merely if the public becomes interested, in the sense of being "affected" by the business. But as Justice Field observed, "A tailor's or a shoemaker's shop would still retain its private character, even though the assembled wisdom of the state should declare, by organic act or legislative ordinance, that such a place was a public workshop, and that the workmen were public tailors or public shoemakers."

Archive Photos

The natural rights reasoning that led to the abolition of slavery also entailed the freedom of moral agents to make their own contracts.

In that same dissent in *Munn*, Field also made the most resounding statement of the moral ground for limiting the claims of property. The anchoring maxim for the law was *sic utere tuo ut alienum non laedas* (roughly: one should so use one's own as not to injure another). Field described that proposition not merely as a maxim of the Anglo-American law, but as a principle of "universal application" that could be used in assessing the rightness or wrongness of any government, anywhere, that professed to be a civilized and lawful government. As Field understood, "whatever affects the peace, good order, morals, and health of the community comes within [the] scope" of that maxim:

> If one construct a building in a city, the State, or the municipality...may require its walls to be of sufficient thickness for the uses intended; it may forbid the employment of inflammable materials in its construction, so as not to endanger the safety of his neighbors; if designed as a theatre, church, or public hall, it may prescribe ample means of egress, so as to afford facility for escape in case of accident; it may forbid the storage in it of powder, nitroglycerine, or other explosive material; it may require its occupants daily to remove decayed vegetable and animal matter, which would other-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

> wise accumulate and engender disease; it may exclude from it all occupations and business calculated to disturb the neighborhood or infect the air. Indeed there is no end of regulations with respect to the use of property which may not be legitimately prescribed, having for their object the peace, good order, safety, and health of the community, thus securing to all the equal enjoyment of their property....

It was not the business of judges to fill in these details of regulation. That power was left, properly, to the judgment of political officers who were more directly accountable to the public through elections. Field sought to show what a vast field of discretion would be left to those officers, without the interference of courts—so long as those officers could establish at least a plausible connection between their measures and the "peace, good order, safety, and health of the community." What Field and the conservative judges sought to teach over the years was that the line that marked off this jural field did not depend on subtle and refined reasonings. It would not require more discretion—and more power—in the hands of judges. On one side of the line would be that vast body of regulations that bore some rational relation to the public health and safety. And the crossing of the line would set off alarms, or send some conspicuous signals: the move into dubious regulations would be marked by the appearance of certain "arbitrary" procedures, and by distinctions that could not quite be explained.

Field's anchoring maxim: one should so use one's own as not to injure another.

Enjoining Arbitrary Enforcement

There is no clearer or more dramatic example on this point than the turnabout produced by Field and his colleagues in two sets of cases sprung from the same set of regulations from the same city, just one year apart. In 1884, the board of supervisors in San Francisco passed a series of ordinances regulating the location and the operating hours of laundries. Because there was a concentration in this business of Chinese immigrants, there was some suspicion that these local measures were really covert schemes to erect barriers to the Chinese. But in two cases, in 1885, Justice Field wrote for the Court in sustaining the regulations as legitimate uses of the police powers to protect the public safety. The business of laundering required continuous fires, and since the business was often run around the clock, the fires were maintained through the night. That those fires could pose a public hazard in a coastal city with high winds seemed a plausible concern. And that the fires "should cease at certain hours of night" seemed, to Field and his colleagues, "a reasonable regulation as a measure of precaution."

But a year later, in *Yick Wo* v. *Hopkins*, the Court was moved to an entirely different judgment in a case testing another part of those regulations: Laundries housed in wooden buildings could have their licenses denied by the board of supervisors without the need to supply a reason. The judges found in this scheme an invitation to the most arbitrary, invidious judgments, and their suspicions were borne out in the results: The only attribute that connected Yick Wo and the 200 other applicants rejected by the board was that they were Chinese. Of the 80 applicants approved by the board, none was Chinese. The law might have seemed fair on its face, but as Justice Stanley Matthews wrote, in that memorable passage, the law was administered "with an evil eye and an unequal hand."

For Justice Field and his colleagues, the difference between these judgments did not turn on reasonings overly refined, but on canons of justice writ large. They could identify, instantly, the signs of arbitrariness in the law, and they could fly to the defense of a Yick Wo. But at the same time, they did not think they bore a license to interfere in any measures of a local government that were plausibly directed to the public health and safety. The same moral premises that moved them to the defense of Yick Wo also enjoined them to respect the limits that were rightfully placed by local authorities on the uses of private property.

Bork's Disdain

In later years, commentators on the law would persuade themselves that there was something nebulous, subjective, arbitrary about "natural rights," and they discredited the possibility that the judges could actually make the kind of discriminations that guided Field and Matthews. And so the awareness of these distinctions began to disappear from the commentaries and the histories. What remained were the portraits of judges, swollen with conviction, suffering little inhibition as they went about striking down local laws in the name of "substantive due process" and the "immutable principles of justice." The judges who had brought to the cases the most calibrated lens for detecting arbitrariness would be portrayed in our own time as exemplars of the most arrant arbitrariness. Their names would be taken as synonyms for the flexing of raw judicial power.

Even Robert Bork added to the derision of Rufus Peckham for Peckham's famous opinion in *Lochner* v. *New York* (1905). That was the case in which the Supreme Court had struck down a law in New York that put a limit of 60 hours per week on work in a bakery. Bork esteemed Peckham for some of the opinions he had written on antitrust, but he had such disdain for Peckham's handiwork in the *Lochner* case that he was willing to join the trend of converting the name of the case into a verb: "To Lochner" or "to Lochnerize" became the tag for an activist judge who was willing to enact his own prejudices into the law of the Constitution. As Bork remarked, the name of the case "lives in the law as the symbol, indeed the quintessence, of judicial usurpation of power."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Peckham and his colleagues had sought to vindicate the "liberty to contract," and that term, too, has been converted over the years into a term of mockery. As the liberal wags would put it, the judges were willing to vindicate the liberty of workers to contract for more than 60 hours of work per week, and at less than the minimum wage. But the derision obscured the serious question raised by the conservative judges: Was there any principle that could establish the number of hours that it was "right" for anyone to work, apart from the worker's own judgment about the hours he was able or willing to work, and the wages he was willing to accept?

Respect for Ordinary Men and Women

Peckham's dubiety about the law in New York did not flow from any want of sympathy for bakers. His decision was grounded, rather, in a respect for the competence of ordinary men and women to make their own judgments about the kinds of contracts that met their needs and merited their consent. If the law could prescribe the hours of bakers, then "not only the hours of employees, but the hours of employers, could be regulated, and doctors, lawyers, scientists, all professional men, as well as athletes and artisans, could be forbidden to fatigue their brains and bodies by prolonged hours of exercise."

The notion of a contract drew on the same metaphors that underlay constitutional government, or government by consent. A right to contract could be claimed only by a "moral agent," as Madison said, who could deliberate about the grounds for offering, or withdrawing, his consent. But by the same token, a moral agent had access to the understanding of right and wrong; and therefore he would also understand the ends he had no right to pursue, even through the device of a contract. With that understanding, the judges were explicit in pointing out the places in which a person's liberty to contract was very much open to the restraints of the law.

And so, Justice Sutherland could later say unequivocally that "[t]here is, of course, no such thing as absolute freedom of contract....The liberty of the individual to do as he pleases, even in innocent matters, is not absolute. It must frequently yield to the common good." In *Lochner*, Peckham had taken the matter to its moral root: He would defend the liberty of contract, but "[t]he State...has the power to prevent the individual from making certain kinds of contracts...[*e.g.*,] a contract to let one's property for immoral purposes, or to do any other unlawful act." In the jural world of Rufus Peckham and his colleagues, the judges could never be called on to enforce a contract for prostitution, or the "contract" to carry out a murder.

With these moral premises in place, Peckham, the supposed model of a laissez-faire judge, was willing to sustain these regulations: the limiting of working hours, in underground mines, to eight hours per day ("except in cases of emergency, where life or property is in imminent danger") (*Holden* v. *Hardy*, 1898); the limiting of hours of work in smelting plants, where a prolonged exposure could pose risks to the health of workers (also *Holden* v. *Hardy*); the requirement, by a state, that the owners of mines redeem coal for cash when workers are paid in kind (*Knoxville Iron* v. *Harbison*, 1901); the

The Bettmann Archive

In his *Slaughter-House* dissents, Stephen Field held that the creation of monopolies was a violation of people's natural rights to enter ordinary trade.

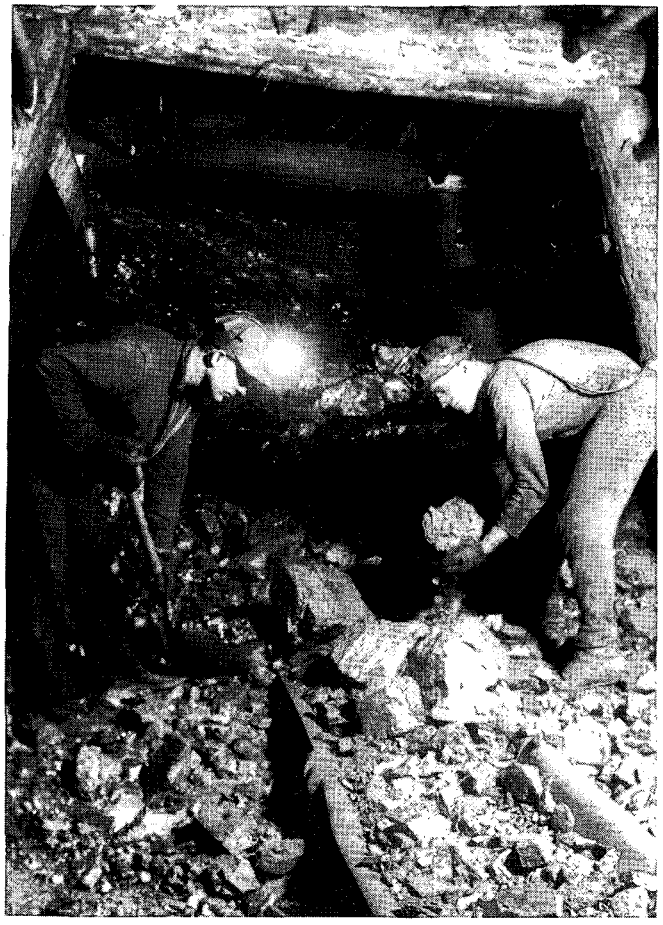
provision of vaccinations in a compulsory way, as part of a policy directed to "the public health and the public safety" (*Jacobson* v. *Massachusetts*, 1905); and the requirement that barbershops and other establishments be closed on Sundays, even though a policy of that kind, too, would limit the hours that people were free to work (*Petit* v. *Minnesota*, 1900).

Peckham found in most of these policies an earnest interest in protecting workers from fraud and hazards, and in promoting public health. He was willing to entertain the possibility that work in a bakery might be less healthy than other kinds of work, but it was not apparent that work in a bakery posed any extraordinary dangers to the health of bakers. He was certain that different kinds of work would be more or less salutary, and yet that epiphany might not warrant the state in legislating a schedule with varying limits to protect people against the strain suffered, at widely different thresholds, by stock brokers, ballplayers, and choreographers.

The Maturity of Willie Lyons

Years later, in *Adkins* v. *Children's Hospital* (1923), Justice Sutherland would write within the same framework acknowledged by Peckham: Sutherland would strike down the minimum wage law for women in the District of Columbia, and he would vindicate the right of Willie Lyons to keep a job she wished to have as the operator of an elevator. Lyons had been quite pleased to accept the terms of $35 per month plus meals,

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED



Bettmann Archive

Rufus Peckham, the supposed model of a laissez-faire judge, was willing to sustain a limit of working hours in underground mines to eight hours a day.

and her employers were quite willing to retain her. Her employers were free to hire a man at the same wage, but they were barred by law from employing any woman at less than $71.50 per month. As Justice Sutherland wrote, "We cannot accept the doctrine that women of mature age, *sui juris*, require or may be subjected to restrictions on their liberty of contract which could not lawfully be imposed in the case of men under similar circumstances."

But even as Sutherland overturned the law in the District of Columbia, he sought to explain what made this law different from the many other regulations by local government that the Court was willing to uphold. There had been, most notably, several cases upholding restrictions on the hours of labor for women. In *Muller* v. *Oregon* (1908), the Court had sustained a statute that forbade the employment of females in certain industries for more than 10 hours a day. The judges were willing to uphold these restrictions more readily as measures that were justified by the peculiar nature and vulnerability of women. Sutherland had been a leader in the cause of votes for women, but the argument for political equality did not entail, on his part, a willingness to overlook "differences in physical structure, especially in respect of the maternal functions." And those differences could justify restrictions on the hours of labor, which the judges would have tested more strenuously if they had not been focused on women. But of course, not all women were frail and vulnerable in the same way, and if women were competent to reach their own judgments on the wages that were acceptable to them, it was hard to see why that same competence would not command a comparable freedom to reach their own judgments about where and how long they were willing to work.

Still, in accommodating these statutes, Sutherland and his colleagues were willing to accept a more refined distinction between the regulation of hours and wages. The regulation of hours might have a more evident, plausible connection to guarding the health of workers. But the fixing of wages imported a vast array of arbitrary theories about the wages and prices that were "just" or equitable. At least, with the regulation of hours, the employer and the employees were still free to bargain about the wages that would be mutually acceptable. And so, Sutherland and his colleagues were willing to uphold: a statute in Oregon forbidding the employment of any person in a mill, factory, or manufacturing establishment for more than 10 hours per day, and stipulating payment for overtime that would not exceed three hours in any day, with compensation at the rate of "time and a half of the regular wage" (*Bunting* v. *Oregon*, 1917); and the Adamson Law, a federal statute that established an eight-hour day for employees of interstate carriers, but along with a schedule of minimum wages, with provisions for overtime pay (*Wilson* v. *New*, 1917).

Sutherland's willingness to go along with these statutes signaled his willingness to defer to the policies set by elected officials, even when they collided with his better judgment, and his demanding sense of the principles that were bound up with the Constitution.

The Constitutionality of Zoning

Sutherland has mainly been dismissed by liberals as one of the "Four Horsemen" (with James McReynolds, Willis Van Devanter, and Pierce Butler), the judges who resisted the New Deal. But he has also been condemned by many free-market conservatives as the judge who wrote the landmark opinion in 1927 accepting the constitutionality of "zoning laws" (*Village of Euclid* v. *Ambler Realty*). His moral inclination here was to presume in favor of local regulations rooted in the genuine concerns of the police powers. For Sutherland, "zoning" warranted respect, because it seemed to bear an obvious connection to the public health. Sutherland would not permit himself to speculate on the ways in which the powers of zoning could be misused for the sake of carrying out, in effect, the taking of property without compensation. He thought that the laws of zoning would find their ground in the traditions of the common law on the regulation of "nuisances." And from that point, he identified zoning with the full inventory of measures that had as their object

> [the] promotion of the health and security from injury of children and others by separating dwelling houses from territory devoted to trade and industry; suppression and prevention of disorder [and crime]; facilitating the extinguishment of fires, and the enforcement of street traffic regulations and

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

other general welfare ordinances; aiding the health and safety of the community by excluding from residential areas the confusion and danger of fire, contagion and disorder which in greater or lesser degree attach to the location of stores, shops, and factories.

Natural vs. Positive Law

If this was the era of laissez-faire, then the term must include the acceptance of regulations touching every phase of the public health and safety. The judges were convinced that they had no license to interfere with any measure that came within the police powers of local government, as long as those measures bore some tenable connection to the "health, welfare, and morals" of the population. But this supposed paradox stands as a puzzle mainly for people who have studied law in our own day. To the judges of that earlier generation there was no paradox: The same moral premises that supplied the ground of natural rights, and the foundations for a free economy, also confirmed to governments at the local level the widest latitude to regulate business for the public good.

The expounders of "natural rights" were guided here by distinctions that seem to elude most modern commentators on law. The judges understood the difference between principles of natural law and those practical measures, those regulations of "positive law," by which principles could be applied to the cases that arise in our daily lives.

It was one thing, for example, to understand the principle that enjoined us to avoid the reckless endangerment of lives. That principle could be applied to the condition of our public roads through a variety of measures to regulate traffic and insure safety. But it would not be the business of judges to decide whether traffic signals should be installed, whether speed limits should be posted at 40 mph, or whether roadblocks should be emplaced to check the sobriety of drivers. Any one of these arrangements could be compatible with the underlying principle. But no one of them would be strictly enjoined by the principle. There would be a vast field here for the exercise of judgment, and that judgment may turn on considerations that run well beyond the arts, and the distinct competence, of judges.

Keen Moral Sense

The judges could become engaged, rightly, again if some of these devices began to incorporate means that were questionable in principle—for example, if the speed limits were placed at different levels for different races. But for the most part, these judgments may turn on the kinds of considerations that press most vividly on people who run for elective office. They may involve questions of expense, or the ranking of priorities in a local budget. They may involve a need to tailor new regulations to the temper of the local residents and the peculiarities of the local terrain. These officials, elected locally, may be in a better position to determine on the basis of experience whether the community has a more urgent need to attend to violence in the streets, or the coarseness of public entertainments, or the defective wiring in private homes.

Bettmann Archive

Justice George Sutherland: "There is no such thing as absolute freedom of contract."

The commentators who have condemned these judges for meddling with local regulations have been largely inattentive to the tiers of judgment that the judges would never enter, and the layers of restraint they were willing to honor. Their interventions were rare, and selective, and bound by the discipline of judges.

Judges like Stephen Field understood precisely the moral grounds on which the law would be justified in restraining the uses of property. For that reason, they were clear on the difference between a regulation that was justified and a regulation that took on the features of "arbitrariness." They could be clearer, then, in recognizing the instances in which the zeal to regulate business would detach itself from the ground of a moral argument, or the properties of a justification, and simply turn into a project of theft, covered over with moral pretensions. They could pierce the rhetoric of lofty ends, offered as a benign cover, and describe plainly the project before them: that groups pursuing their interests and annexing to themselves the levers of law manage to confiscate the property of some people and transfer it to themselves.

They were sufficiently rooted in the moral ground of the law that they required no feigned moral conviction. They could summon a moral outrage, properly grounded, and they could draw from the principles of lawfulness the lens that would sharpen their sight in the cases at hand. Fueled with that conviction, and tutored by those doctrines, they could write plainly in describing, and precisely in condemning, the wrongs that passed before them.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Hollywood Discovers the Gulag

The Inner Circle, directed by Andrei Konchalovsky

Reviewed by John V. N. Philip

Anastasia: "Who do you love better, me or Comrade Stalin?"
Ivan: "Stalin of course."
Anastasia: "And I love you most of all in the world."

Columbia Pictures' new release, the masterful *Inner Circle*, is one of the first Western films to indict the evil of the former Soviet Union. Nazi barbarism and totalitarianism have been the subject of scores of feature films and television movies, both fictional and documentary. Other regimes receiving similar treatment have been Franco's Spain, the Greece of the junta, various Latin American military cabals, and most recently South Africa. But until recently, the totalitarian horrors of the Soviet Union have remained largely unexplored on screen.

The exigencies of World War II limited any realistic cinematic portrayal of the Soviet Union, producing unabashedly sanitized pictures designed to reinforce the Allied wartime alliance. The outbreak of the Cold War reversed this theme, producing scores of films depicting Soviet agents and sympathizers infiltrating and sabotaging the West, and occasional background views of the Eastern Bloc in stories recounting the adventures of Free World agents operating beyond the Iron Curtain. But Taylor Hackford's 1985 hit *White Nights*, starring Mikhail Baryshnikov, also distributed by Columbia, was the first contemporary film seriously to examine the morbid inner workings of modern Soviet oppression.

Now, with *Inner Circle*, we have serious cinematic treatment of the crimes of Stalin. Director Andrei Konchalovsky's signal triumph is his screenplay (jointly authored with Anatoli Usov), which depicts the true story of Stalin's personal film projectionist, Alexander Ganshin. In a story metaphorically applicable to most of Soviet history, the screenwriters lay bare the human behavioral sources of the Soviet totalitarian experience: political infantilization, the corruption of personal morality, and the brutalization and humiliation successively transmitted down the social ladder. Nevertheless, the story offers hope. In its climactic scene *Inner Circle* reasserts the transcendent power of an individual's love to restore humanity to his tyrannized soul.

Long one of Russia's preeminent directors, Konchalovsky demonstrated early in his distinguished career an ability to paint a definitive portrait of despotism. His screenplay for noted director Andrei Tarkovsky's epochal *Andrei Rublev*, with its masterful story of the degradation of Russia during the Mongol invasions as seen through the eyes of Russia's greatest icon painter, displayed his extraordinary ability to illuminate the panorama of oppression through personal witness.

"Father to Us All"

The story of *Inner Circle* begins in the spring of 1939. The world poises for war. The purges are under way. Ganshin, renamed in the film Ivan Sanshin, a projectionist at the KGB club, has just emerged from an upbringing steeped in Soviet propaganda, as an orphan in a state institution and then a member of the Red Army. He reveres Stalin. "The man we called master was more than our ruler," he intones in the film's opening narration, "he was father to us all."

The very night of his wedding celebration to his beloved Anastasia, the KGB (then called the NKVD at that time) arrives twice at his dingy communal apartment; first to arrest his neighbors, the Gubermans, then to draft him as Stalin's personal projectionist in the Kremlin. Over the next two years he thrills in his ascending good fortune: better salary, better food, the better room formerly belonging to his arrested neighbors, the self-importance that comes of flattering himself a member of Stalin's "inner circle." He exults in such treasured moments as being allowed to share a glass of tea with the dictator and other members of his entourage as a reward for an impromptu repair of a faulty projector.

His pitifully naive adoration of Stalin leads inexorably to his many, and eventually fatal, betrayals of Anastasia. Days following the arrest of Guberman and his wife, the KGB arrives for the infant Katya, whom Anastasia is hiding in the Sanshins' room. Mindless of any imperative save his own terror at personal linkage with the condemned Gubermans, Ivan tears the terrified child from his wife's arms and presents her to the secret police. Anastasia continues secretly to visit the child at a state orphanage. When the KGB discovers this, and

JOHN V. N. PHILIP *has been an actor and producer. He is currently an attorney living in New York City.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

threatens Ivan, he turns on his wife in a frantic rage and forces her to forswear the little girl.

Most momentously, he abandons Anastasia herself when Lavrenti Beria, head of the secret police, catching sight of her on the special train carrying Politburo members fleeing Hitler's advance on Moscow, takes her for his mistress. "You killed me," she says to her husband on her return a year later, understanding his helplessness in protecting her, but despairing that she received no word from him during their forced separation. Her discovery that he wrote the letters but never mailed them, afraid of being found out, irreparably escalates her hopelessness. Now pregnant with the KGB chief's child, she hangs herself.

Maelstrom of Tyrannies

The totalitarian social order entrapping Ivan and Anastasia is actually a permanently unstable pyramid spreading downward from the dictator himself. Many "little Stalins" terrorize those below. Yet those beneath, in certain circumstances, may denounce and help dethrone all but the tyrant himself. Stalin humiliates and threatens ministers and generals, they curse colonels, colonels torment aides, aides cruelly jest with Ivan, Ivan beats his beloved Anastasia. In one sequence, as a small army of officers and technicians readies the private Kremlin cinema for a screening, among other preparations vacuuming the air to test for potential poisons, a colonel upbraids a terrified aide for wisps of cigarette ash on a cuspidor. The same officer, moments later, faces the menacing wrath of a general who discovers a bottle of mineral water loosely capped. Yet at another point a KGB officer reproves Ivan for never reporting political indiscretions by those among whom he works. "I'm not talking about janitors," the KGB official pointedly and ominously advises Ivan.

Nevertheless, despite the maelstrom of tyrannies and consequent self-denial through which Ivan must survive, he eventually is able to begin to redeem his humanity through the memory of Anastasia's love and its renewed physical manifestation in the reappearance of Katya. The Guberman daughter, suffering still from Anastasia's inexplicable abandonment, returns to her former childhood home to discover why. Ingrained self-protective instincts drive Ivan to ask the adolescent not to come again, but her stay reawakens feelings deadened since Anastasia's death 10 years before. A few days later, Ivan, detailed to control the terrified crowd that assembles at Stalin's funeral, catches sight of Katya amongst the hysterical mourners. "Who will take care of me now," she cries, as he pushes her to safety away from the panicked mob. When once asked by his wife a decade before, in the film's epigrammatic moment, if he loved her or Stalin more, he had said Stalin. But now, enfolding Katya in his arms, promising to love and protect her as his daughter, his wife's response at that earlier time floods over him, expressing what now he truly feels for Katya: "And I love you most of all in the world."

Columbia Pictures Industries, Inc.

Sanshin and his object of adoration.

Smashed Taboo

The world of Western cinema was crippled by the varied intellectual rationalizations evolved over decades in the West to accommodate the Soviet monolith. So was the greater intellectual world of which filmmaking is an integral part. From the earliest days of the Soviet Union, thousands of emigré voices and objective observers struggled to tell the truth about the regime. For the most part filmmakers, like many other members of the Western intelligentsia, ignored their stories. The smashing of the seminal taboo, the condemnation of the Soviet state as the evil empire it always truly was, catalyzed a political revolution that culminated in the Russian Reformation of 1991. *Inner Circle* is primary evidence that those who witnessed the staggering cruelty are now, finally, beginning to have the cinematic voice so long unjustly denied them. As this process continues, and ever more films unflinchingly expose the atrocities of Soviet totalitarianism, they will begin to right the heinous system's most monstrous remaining legacy, the horrifying silence enveloping so many of the millions who suffered, died, and disappeared into the Soviet Union's totalitarian hell. Through the imagery of films like Konchalovsky's, we shall remember them—one by one.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

LETTERS

Darrel W. Stephens, John J. DiIulio Jr., Francis X. Hartmann, Walter I. Trattner, Donald Bradley, Lovett C. Peters, Judith A. Best, Elliott Abrams, Bruce Fein, Margaret P. Calhoun, James L. Payne, Marvin M. Vogt, Donald Devine, William A. Niskanen, J. David Hoeveler Jr.

Neighborhood Assistance

Dear Sir:

I read Chief Reuben Greenberg's article "Less Bang-Bang for the Buck: A Market Approach to Crime Control" (Winter 1992) with a great deal of interest. His focus on disrupting the market for illegal drugs clearly seems to have contributed to a reduction in the street-level drug-enterprise in Charleston, South Carolina. The strategy of disrupting the market process for illegal drugs has been supported by research that Harvard professor Mark Kleiman conducted several years ago. It has also recently been tested in Tampa, Florida, with their "QUAD Squad." Chief Greenberg's idea is a good one; I believe it will work in other cities and should be given a try. In today's tight fiscal times for local governments, Chief Greenberg has the right attitude. He made the best use of the resources available to him and was not afraid to risk using these resources to try a new approach.

I worry, though, that the chief might be giving the police too much of the credit for the decline in reported crime. No doubt, the police made a contribution. The community may have contributed as well, however, once it realized that the police were taking a different approach to dealing with the problem. The police normally use undercover officers, as Charleston did initially, or saturate the area for a few days with uniformed police who then move on to some other location in the city. Once the people in the community had confidence that the police would stick with them until the problem was resolved, I suspect that their behavior and attitudes toward the drug dealers changed and they began to reclaim their neighborhoods, which further contributed to disrupting the drug dealer's market.

Darrel W. Stephens
Executive Director
Police Executive Research Forum
Washington, DC

Greenberg-style Intervention

Dear Sir:

Chief Reuben Greenberg knows what most average Americans but few criminologists know: namely that where crimes are harder to commit, fewer crimes are committed. He scared off would-be drug customers by stationing cops within two first downs of drug dealers. He got local jail inmates to clean up the areas. He brought safety to the projects by legally hawking the predators who lived there. And he did it all without needing more staff or a bigger budget.

Of course, self-styled criminal-justice experts will tell the chief that Charleston is not New York City, Los Angeles, or Washington, D.C. The chief should ask them this question: "Do you know of any alternative approach that, other things being equal, has been demonstrated to work as well as what I have done in Charleston?" That should quiet them.

And, self-styled civil libertarians—the type who insist that mentally ill homeless fellow citizens have the "right" to freeze to death on the streets rather than be institutionalized against their will—will tell him that his efforts to police the projects are unconstitutional. In response the chief should propose the following experiment: Identify two equally distressed and crime-torn projects. One gets Greenberg-style intervention, the other does not. The civil libertarians exercise their right to live for a year in the latter project. See what happens to crime rates in each project—and how long the civil libertarians last.

People who are economically disadvantaged deserve protection from the criminal deviants who live among them and worsen their plight. I applaud what Chief Greenberg and his officers have done. It is an example of community policing that has really made a difference.

John J. DiIulio Jr.
Director
Center of Domestic and
Comparative Policy Studies
Woodrow Wilson School
Princeton University

Right to Privacy

Dear Sir:

Reuben Greenberg is ingenious and creative. He has given us examples of re-thinking the business of policing. While other cities can (and some do) utilize Charleston's street-level tactics of scaring off the customers, too many still spend valuable resources looking for a "Mr. Big" who will quickly be replaced. The department's use of counter-graffiti is marvelous. The screening of public housing tenants is fair and helpful to the other residents as long as unfounded allegations are not taken into consideration.

The police "doorman" to the housing project is another one of Chief Greenberg's wonderfully creative ideas aimed at protecting those who desperately need protection. It

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

does give me pause, however. Residents of public housing shouldn't have lesser *rights* than the rest of us. A police check and a list of those entering make me uncomfortable. Residents do have rights of privacy.

Chief Greenberg, like the rest of us, will err, but his erring is on the side of public safety. Given the system of checks and balances on police activities, which includes his ingenious consultation with the ACLU, his creativity is needed.

Chief Greenberg's efforts raise three questions: How do police departments become creative? How are creative approaches institutionalized within a police department? And, how can a police department involve the citizenry in law enforcement to the point that the community protects the gains made by the police?

Francis X. Hartmann
Executive Director
Criminal Justice Policy and
Management Program
John F. Kennedy School of
Government
Harvard University
Cambridge, MA

Mormons Are Unholy Dolers

Dear Sir:

I read Tucker Carlson's article ("Holy Dolers: The Secular Lessons of Mormon Charity," Winter 1992) with great interest and, I must say, a good deal of dismay. Certainly there is much to applaud in the Mormon welfare system, as Mr. Carlson describes it, particularly its alleged efforts to end dependency, its attempt to provide work for the needy, its apparent anonymity, and the like. Yet, the only lesson it offers other welfare programs, secular or religious, public or private, is this: do not follow suit.

The Mormon home visitor program bears remarkable similarities to the famous, or infamous, "friendly visitors" of the 19th-century charity societies. Like their Mormon counterparts, they too operated on the assumption that poverty was an individual, largely behavioral matter, and that the poor therefore needed, above all, advice on how to become good self-supporting individuals, largely by overcoming their presumed immorality and indolence. As all students of American history know, however, the charity organization movement failed. It neither helped the poor nor reduced their number because it did nothing to address the real causes of poverty: social and economic conditions over which the needy had little or no control, such as ill health, low wages, and involuntary unemployment.

Mr. Carlson, and apparently most Mormons, believes that the destitute and the dependent do not want to work and thus must be forced to do so through deprivation. Nothing

could be farther from the truth. While there are some lazy people who would prefer to live off the dole or the labor of others (this includes some of the rich as well as the poor), virtually all scholarly studies indicate that the overwhelming majority of welfare recipients would prefer to work for a living—at a decent job for a decent wage. Furthermore, millions of welfare recipients are working, often 40 hours a week or more, but at such low wages and without benefits, that they cannot support themselves and their families. They need public assistance to supplement their earnings in order to survive.

Mr. Carlson applauds the fact that Mormons apparently "see welfare not as a right, but as a gift," another 19th-century precept. To begin with, welfare is, and should be, a right. American citizens who are poor through no fault of their own, whether it is due to poor health, plant closings, or whatever, have always had, and continue to have a statutory right to welfare—and they should. In a society where racism and sexism are pervasive, where recession after recession have thrown millions of people out of work, where homelessness has reached unprecedented proportions, and where the largest single group of poor people are young children, to argue that "an individual's welfare lays squarely with that individual and nowhere else" is a bit peculiar and misguided, to say the least. Perhaps it would be better or more accurate to dub supporters of Mormon ideas about charity "unholy dolers."

Walter I. Trattner
Professor of History
University of Wisconsin
Milwaukee, WI

Tucker Carlson replies:

Walter Trattner correctly compares Mormon welfare to 19th-century charity organizations. Both were founded on the same principles: a belief that poverty usually could be overcome through hard work and upright living, and a conviction that labor is good for its own sake. As appealing as these ideas may sound, they are fighting words to Professor Trattner. They imply that personal responsibility plays a role in the condition of people's lives. In an effort to discredit them Professor Trattner says that "As all students of American history know,...the charity organization movement failed." This statement, as all professors of American history should know, is false. Very little hard data exists on 19th-century charity organizations, certainly not enough to show that they failed to help the poor. Perhaps Professor Trattner misunderstands the point of Mormon, and 19th-century, charity. Mormons do not try to eliminate poverty entirely. They know, as Jesus did, that some people will always be poor, at least in relative terms. Instead, their system aims to make the poor independent—a much more difficult task than redistributing wealth.

Professor Trattner claims that the average welfare recipient would work if only he could find "a decent

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

job at a decent wage." I suspect that most people would take any job, as long as it was "decent" enough. There is no question that entry-level jobs are often boring, difficult, and low-paying. Still, people who are not willing to enter the job market at the bottom—cooking french fries or pumping gas—do not deserve to be supported by people who are willing.

Finally, Professor Trattner cites the bugaboos of racism and sexism as forces behind poverty in America. If 20 years of affirmative action, minority set-asides, and black history months have shown us anything, it is that racism is no longer the viable excuse for failure in America that it once was. Racism has not kept Korean shopkeepers in Compton, Watts, or the south Bronx from succeeding. Regardless of the realities, however, there always seems to be a persistent chorus of grumblers telling the poor that, no matter how hard they try, they are doomed to fail. And it is not hard to see why. Liberals like Professor Trattner, professional advocates for the oppressed and impoverished, have the most to lose from the poor becoming independent.

The Specter of Taxation

Dear Sir:

James L. Payne discusses the costs of tax compliance in his Winter 1992 article, "Unhappy Returns: The $600-Billion Tax Ripoff." I know these costs first hand.

When I started my business in 1959 I made two naive assumptions. First, I believed that if I could survive and prosper for 10 years then I would have succeeded and would not have to work as hard in the future. Second, I thought that once I learned the tax laws I could tailor my business to conform to them and my tax worries would be mostly over. Both assumptions proved to be dead wrong.

Like all businessmen, my main priority is to make a profit when conducting business. I have found, though, that the specter of taxation is never far behind me, looming in the shadows. Taxes are so pervasive that my subconscious thought in every business and personal decision that I make is: "What are the tax consequences of this move?" Only when this question is answered do I go forward.

I spend untold hours reading publications and newsletters that specialize in tax matters, gleaning whatever information I can use to my benefit. Others must do the same, as these publications have a considerable circulation. After my business and my family, the government—federal, state, and local—is the biggest thing in my life. I estimate that I spend one-third of my time complying with government

regulations, or trying to mitigate their effect on me. I also spend a lot of money on attorney and accountant fees. Just think of the money and time required to create and maintain an estate plan including trusts and living wills. There must be a better way.

Donald Bradley
Plainfield, NH

Wasted Time

Dear Sir:

James L. Payne is right to point to the costs of tax compliance as a major burden on the economy. In 1957 and 1958 when I was financial vice president of Continental Oil Company in Houston I kept a diary and at the end of two years estimated the percentage of my time that was spent in the general area of taxes. It turned out that approximately 40 percent of my time in those two years was spent on taxes and tax avoidance, the tax department being one of the branches that reported to me.

So much of our financing was geared to obtaining lower-cost money through using particular aspects of the internal revenue code and buying properties and financing them with before-tax, rather than after-tax, dollars. The end result surprised even me.

I think it would be very useful if someone were to ask a couple of finance executives in big corporations to estimate the amount of their personal time—not that of their staffs—that is devoted to reducing their company's tax burden.

Lovett C. Peters
Chairman
Pioneer Institute for
Public Policy Research
Boston, MA

Foreign Policy Is Executive Domain

Dear Sir:

David Brock's argument that congressional conservatives have played an important role in modifying foreign policy ("Mr. Symms Goes to Jamba: A Kind Word for Congress in Foreign Policy," Winter 1992) is probably correct and should be heeded. Of course, congressional involvement in debating and pressuring (within constitutional boundaries) the president on foreign policy is appropriate and may even be beneficial. The Constitution does not place making foreign policy outside the daily political process. In terms of foreign affairs, distribution of powers is a policy choice.

In general, though, foreign policy-making is the prerogative of the president. This is imperative because presidential dominance in foreign policy-making is essential for good policy outcomes. When collectives, like Congress, dominate the foreign policy-making process, the product is weak, dilatory, vacillating, and indecisive policy.

We quoters of *The Federalist* have good reason for defending the president's constitutional prerogative in foreign policy against congressional trespass or usurpation. Long experience, as well as analysis, (from Aristotle through Jefferson), of the relative leadership capacities of legislative collectives and single executives support Hamilton's axiom that "Energy in the executive is a leading character in the definition of good government." The

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

capacity for vigorous, resolute, effective action in foreign policy resides, and must reside, in the president and not in Congress.

Judith A. Best
Distinguished Teaching Professor
State University College at Cortland
Cortland, NY

Congress Needs Disinfectant

Dear Sir:

David Brock has given conservatives a useful reminder. As the Democrats have controlled Congress for ages, and that party's liberal wing has controlled the Democratic Caucus (at least in the House), we have too often said "Congress" when we meant "liberals." As in "Congress has screwed up our foreign policy," or "congressional intervention almost lost us the Cold War." We need to identify the problem more carefully, faulting the culpable parties rather than the branch in which they work.

The Constitution clearly affords Congress a large role in foreign policy, and, as Mr. Brock points out, members have often performed that role with distinction. I would only add that, in recent years, some members have performed that role shamefully. Negotiating secretly with foreign governments, and sometimes hostile foreign governments, is not an appropriate activity for members of the legislative branch. Not so many years ago it would have been unthinkable, and one hopes such abuses will not soon recur. Justice Brandeis once noted that "Sunlight is the best disinfectant," and in that spirit perhaps the best way to prevent recidivism is to shine some light on the abuses and the abusers. House Republicans are trying, and their effort is very much worth supporting.

Elliott Abrams
Senior Fellow
Hudson Institute
Washington, DC

Congress Has Not Changed Its Spots

Dear Sir:

David Brock wrongheadedly sounds the call for an enlarged role for Congress in international affairs. The foreign policy follies of Congress are legion, as Mr. Brock in part concedes. The Neutrality Acts of the 1930s virtually invited World War II. President Franklin Roosevelt was compelled to contrive naval incidents with the Nazis to build congressional support for the Allies prior to World War II. The draft extension in 1941 passed the House of Representatives by a single vote despite the impending calamity at Pearl Harbor. Congress demanded instant military reductions after World War II, which enabled Stalin to flout the Yalta Accords. Aid to Greece and Turkey in 1947, the Marshall Plan, NATO, CIA covert action to prevent Communist takeovers in Italy, France, the Philippines, Iran, and Guatemala, and warring against North Korean aggression in 1950 were all executive branch initiatives. Congress was either obstructive or passive in these enlightened enterprises.

Congress is institutionally unsuited for anything but an oversight role in foreign policy or national security. As a body, it is ignorant, supine, vacillating, and myopic.

—Bruce Fein

The Vietnam era and its aftermath witnessed ill-conceived congressional intrusions on foreign-policy prerogatives of the presidency: prohibitions on the bombing of Cambodia; the War Powers Resolution; a denial of the military aid that could have prevented North Vietnam's conquest of South Vietnam in violation of the 1973 Paris Peace Accords; and the Intelligence Oversight Act, which ruined covert action as an instrument of foreign policy. But according to Mr. Brock, Congress has changed its spots, at least recently, with the exception of Congress's minor aberration of Nicaragua. His examples, however, are unconvincing.

Afghanistan: Since the 1979 Soviet invasion, the executive supported military and humanitarian aid to the Afghan mujahideen. Saudi Arabia and Iran were also hefty benefactors. Some members of Congress championed increased U.S. support, but that was not decisive in the Soviet withdrawal. Mr. Brock boasts that Senator Orrin Hatch single-handedly precipitated the end of the Cold War and the Soviet retreat from Afghanistan by convincing the executive to send Stingers to the resistance in 1986. Few share that delusion.

Angola–Cambodia: After Congress threw both of these nations into the hands of Communists (the MPLA and Pol Pot), but prohibited U.S. support for their adversaries in the 1970s, Mr. Brock cheers subsequent marginal repentance by Congress in the 1980s in its support of UNITA and the Cambodian resistance. But do these about-faces demonstrate congressional competence in foreign affairs?

SALT II: Congress repeatedly sought to mandate executive adherence to the unratified SALT II treaty and nuclear testing treaties through appropriations measures. Mr. Brock turns history on its head in portraying Congress as a steady SALT II opponent.

SDI: Congress has consistently slashed funding requests for strategic defense. It has further attempted to bind the executive to a narrow interpretation of the ABM Treaty to forbid space-based defense.

Communist China: Mr. Brock lionizes congressional efforts to deny the PRC most-favored-nation status unless it respects human rights. But denial would not alter the PRC's domestic policy, and the Bush administration's continuance of trade has made the PRC cooperative in a Cambodian peace settlement

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

and in stanching North Korea's nuclear weapons programs.

The reforms of the Reagan and Bush administrations were achieved despite congressional obstruction or passivity in El Salvador, Grenada, and Panama. The executive, not Congress, insisted on the Pershing II and GLCM deployments in Western Europe that achieved the INF Treaty breakthrough with the Soviet Union and its subsequent unraveling. If Congress had its way, via the perennial Mansfield Amendment, the U.S. would have yielded Western Europe to the Iron Curtain before Gorbachev arrived. Nor does Mr. Brock discuss the South Africa Anti-Apartheid Act, the congressional noose on covert action that has preserved Libya's Qadhafi and Iraq's Hussein, congressional demands for wasteful weapons and military bases to propitiate domestic constituents, and congressional lunacy in demanding a porous interpretation of Germany's and Japan's no-war constitutions to send a handful of superfluous troops to the Persian Gulf. At present, Congress is urging a dismantling of the nation's defenses, emulating its unwisdom after World Wars I and II, which threatens posterity with a Pearl Harbor redux.

Congress is institutionally unsuited for anything but an oversight role in foreign policy or national security. As a body, it is ignorant, supine, vacillating, and myopic. The Soviet empire would not have collapsed if the reins of U.S. foreign policy were held by Congress. To paraphrase Winston Churchill, a unitary executive is the worst institution for making foreign policy, except for all the other alternatives.

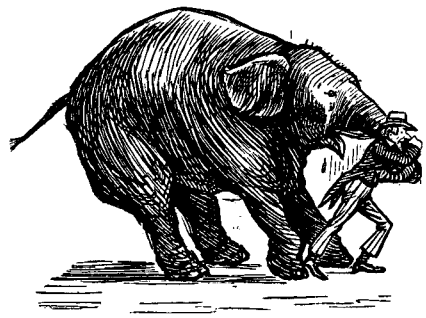
Bruce Fein
Great Falls, VA

Conservatives Won Angola

Dear Sir:

David Brock, citing many instances of conservative foreign policy successes in Congress, justifies a more active role for conservatives in foreign affairs. A prominent example of Congress's successful intervention that Mr. Brock grazes, but that warrants elaboration, is Angola. Jonas Savimbi's UNITA, a resistance movement expected to win Angola's first free elections this September, was deemed *persona non grata* by the State Department during both the Carter administration and the first term of the Reagan administration.

When conservatives began lobbying for arms to Savimbi to fight the Soviet and Cuban-backed MPLA regime, one prominent State Department African expert warned that aiding Savimbi would be a public relations disaster for the



United States in Africa. Other Africa policy elites, in a synchronized chorus, claimed Savimbi had no chance of winning his guerrilla war and that the United States would be viewed as bedding down with South Africa, which was supplying the UNITA rebels. Yet Savimbi was a true nationalist, an advocate for multipartyism long before it became popular in Africa, and 14 years before Africa began to undergo its own Eastern Europe-style metamorphosis.

UNITA, unable to get any cooperation from the State Department Africa Bureau, which it then regarded as implacably hostile and manipulative, sought the assistance of Senator Steve Symms. Symms had already demonstrated his interest in the forgotten Angola war in 1984, risking anti-aircraft missiles to fly at treetop level into Savimbi's bush camp in southern Angola to meet with the UNITA leader.

Despite Congress's policy reversal with the repeal of the Clark Amendment, and presidential assurances of "effective and appropriate" assistance to UNITA, chronic problems with State Department and CIA bureaucrats on Angola policy persisted. Savimbi's frustration with the Reagan State Department was evident. At one point he cried out, "Is [Chet] Crocker [assistant secretary of state for African affairs] trying to dig our graves?"

As recently as the winter of 1990, White House Chief of Staff John Sununu was called upon by Senate conservatives to intervene in a CIA supply cut-off to UNITA. The cut-off threatened the rebels with the loss of Mavinga, a strategic town in the war's final battle. Sununu's calls to key Cabinet officials turned the flow of arms back on and salvaged UNITA. A year later, negotiations yielded a peace agreement, a lasting ceasefire, and the promise of free elections.

Despite evident successes such as Angola, conservatives continue to disagree over their proper role in foreign policy. One argument advanced is that conservatives should set an example by permitting the president to run foreign policy without their interference. David Brock readily cedes that the Left has been more successful in influencing foreign affairs since Vietnam, but he rightfully concludes that the Left is not going to back off if conservatives adopt a "hands off" attitude.

Nor can conservatives wistfully fantasize about the good old days when "politics stopped at the water's edge." Conservatives must become more involved in foreign policy to support the president when his agenda is undermined by resistant bureaucrats, and more important, because conservative inactivity would abandon foreign policy to increasingly active and radical congressional interventionists.

Margaret P. Calhoun
Senior Africa Analyst
International Freedom Foundation
Washington, DC

David Brock replies:

The points made by Elliott Abrams and Judith Best are well taken. I would simply add that I am not against the notion of "energy in the executive"; in fact, a divided and reactive executive branch often is responsible for unwanted congressional incursions.

Bruce Fein has two major objections to my article, one to its general thrust and the other to its specific examples. I will only address the latter objections, as they go to questions of fact. The record is clear that

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the executive branch never supported effective military aid to the Afghan freedom fighters. Had it not been for Congress, the Soviets might still be in Kabul.

As for Angola and Cambodia, I agree with Mr. Fein that the congressional policies of the 1970s were wrongheaded. Sometimes Congress makes good decisions, and sometimes it makes bad ones. My point is that conservatives should not regard the institution of Congress with knee-jerk hostility on account of the bad decisions, while ignoring the lessons of the good ones.

I am quite aware of the congressional attempts to tie the Reagan administration to SALT II; since the scope of my article was limited to conservative congressional activism, I only discussed congressional efforts to get the Reagan administration to rescind its commitment to abide by the unratified SALT II accord.

It is clear that if the United States finally gets a ballistic missile defense, it will be the handiwork of Senators Nunn and Wallop, not the Bush administration. Finally, Mr. Fein and I will have to agree to disagree on the appropriate American policy toward China. I would note, however, that Mr. Fein's policy preference doesn't command a congressional majority and is therefore politically untenable, regardless of its other merits.

Unlike Mr. Fein, who spends his time thinking about theoretical constitutional issues, Margaret Calhoun has seen as a Capitol Hill staffer how the foreign-policy process really works. Conservatives would do well to learn from her experience.

Slash Hill Staff

Dear Sir:

In "What We'll Do When We Reach Majority (Winter 1992)," Republican Congressmen Robert H. Michel, Dick Armey, and William F. Goodling rightly identify the reduction of congressional committee staff as needed reform. Staff reduction is more than a money-saving device; it would improve policy-making. When large numbers of people are involved in the process of drafting laws, the result is usually complex, incoherent legislation.

The tax code illustrates the point. Back in 1951, the House Ways and Means Committee had seven professional staff, and the tax system was rather well-managed by a handful of congressmen who mastered the legislation they were proposing. Today, the Ways and Means Committee has a staff of 90, and it has been years since congressmen have been able to read, let alone digest, the hundreds of pages of tax legislation they enact into law. Tax law is now fashioned the way a Christmas tree is decorated: everyone hangs his favorite ornaments on it. The result, in the words of tax law professor Richard Doerberg, is "the most complex income tax laws in the history of civilization."

While all three Republican congressmen agree that staff reduction is the right medicine, they are disappointingly timid in the dosage they recommend. To counteract staff increases of some 1,300 percent in recent decades, Congressman Michel recommends a 50-percent reduction, Goodling advises a 33-percent reduction, and Armey proposes a 27-percent cut. Even if these "wish-list" targets were achieved, Congress would still be left with staff levels some six to nine times the healthy proportions of the 1950s.

The feebleness of these proposals demonstrates the insidious power of Washington's "culture of spending." Congressmen grow used to operating the levers of power and are reinforced in their presumption by a continuous stream of pro-government propaganda. This brainwashing turns ordinary liberals into wild-eyed spendthrifts and seduces conservatives into accepting bloated government as normal.

In the long run, no one can resist the siren call of the spending advocates in Washington. That is why we must have term limits. It is the only practical way to cut short the indoctrination process and give us a renewed Congress, one capable of challenging ongoing programs and practices.

James L. Payne
Sandpoint, ID

Congressmen get used to operating the levers of power....This brainwashing turns ordinary liberals into wild-eyed spendthrifts and seduces conservatives into accepting bloated government as normal.

—James L. Payne

Choice Is the Problem

Dear Sir:

At the beginning of his article, "Northern Discomfort: The Ills of the Canadian Health System" (Fall 1991), Edmund Haislmaier says that proponents of Canadian health care claim "a U.S. version could retain the freedom of choice currently enjoyed and valued by Americans." This freedom of choice is at the root of our current health care troubles. No matter how highly valued, choice is the first thing we should look at when considering changes to our health care system.

Thirty years ago there was no health care crisis. There were fewer people insured then than there are now. Nobody, rich or poor, was denied health care. In the debate that took place over Medicare and Medicaid, there were no claims of a crisis. There was no concern over the millions of uninsured. There were no claims that people were being denied needed health care.

The major argument put forth by

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the proponents of Medicare and Medicaid went something like this: "Why should a person not be able to choose his own doctor and hospital just because he is poor?" In short, Medicare and Medicaid were adopted for no reason other than to give the poor and elderly freedom of choice. Certainly a strong argument can be made that Medicare and Medicaid led the way to the current health care crisis.

Thirty years ago the people of this country took care of the indigent with their county hospital system. In many areas county hospitals were the only full-service medical facilities. In many other areas they were the finest, most up-to-date medical facilities. They were supported by property owners through the property tax, which very few property owners complained of paying. In fact, most county residents were proud of their hospitals.

County medical associations required their members to donate a specified number of hours per month to the county hospital. Sometimes specialists from New York, Boston, or other cities came to small towns to treat patients with rare or complicated disorders. These doctors were never paid a fee. Many even refused reimbursement for their expenses.

Those were the days when doctors were the most respected members of their communities. Most doctors had their own private charity patient lists. These patients never received a bill, were billed at reduced rates, or the doctor never made much of an effort to collect the bills he had rendered.

Medicare and Medicaid did away with all of that. They also killed the county hospitals. Outside of major metropolitan areas very few county hospitals remain. Those that do are in serious financial difficulty. Remember, the county hospital system was killed over freedom of choice, not because it did a poor job.

Obviously, when doctors stopped doing charity work and charging according to variable rate schedules, the cost of medical care went up. When the large number of hospitals whose sole reason for existing was to serve the poor were eliminated, medical care became scarcer.

When the responsibility for providing medical care to the poor rested on local communities, there was no health care crisis. It was only when the federal government became involved that a crisis developed.

—Marvin M. Vogt

All of this in the name of "choice." Actually, how important is being able to choose? In my experience the only time that choice means anything is when you don't need a doctor. Almost every time there has been a medical emergency in my family, our regular doctors have been unavailable. In the past couple of years my wife has been hospitalized several times. In none of these events was she able to choose the hospital she used. When she had surgery she only met her surgeon as she was wheeled into the operating room.

Today, a personal physician is good for periodic check-ups, giving shots, and treating minor injuries and ailments. Anything more demands a specialist. If you need your personal physician at night or on the weekend, you will probably be told to go to the outpatient department of the nearest hospital where some doctor you have never seen will take care of you.

The lesson to be learned from the past is this: when the responsibility for providing medical care to the poor rested on local communities, there was no health crisis. It was only when the federal government became involved that a crisis developed. So any reform should be aimed at reducing the federal government's role, not increasing it.

Marvin M. Vogt
Lemoore, CA

Principled Conservatism

Dear Sir:

Edwin J. Feulner Jr. certainly raises some tough questions for the conservative movement in his interview with Adam Meyerson (Fall 1991). Let me comment on a few of the major issues.

Mr. Feulner is rightly concerned with the threat to survival caused by the guerrilla warfare between the two major wings of the movement, insisting there is a natural alliance between economic and social conservatives. Ending the developing antagonism requires that both sides concede the formula that united us: using economically libertarian means for socially conservative ends. Social conservatives must agree that voluntary agencies and local government (not the central government) are the means to the ends, and economic conservatives must realize that these are free means (and that utilizing national power to force libertarian ends upon associations is not). Unless both concede the legitimacy of one as a means and the other as an end, there is no principle upon which they can unite.

Should a movement united upon this broad principle develop independent leadership on Capitol Hill? Certainly, but looking for leadership for limited government from permanent Washington politicians is a contradiction. Mr. Feulner was one of the earliest to emphasize the importance of citizen-legislators as opposed to professional ones, now including pointing to the necessity of ending pensions for legislators—for that is what makes them think like bureaucrats. California did it correctly by limiting staff, terms, and pensions. From personal experience, there are almost no conservatives in Congress for such a program, which is the reason why we must look elsewhere.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The question of whether conservatives should create a new establishment depends upon what "establishment" means. If it means a right-of-center governing class, the answer is no. Our philosophy should tell us that any ruling class will become abusive of legitimate freedom, usually within a very short period of time. If "establishment" means—as I believe Mr. Feulner does—a permanent, principled support for limited government outside of government, then the answer is very definitely yes, create it.

Mr. Feulner is correct that conservatives are a paper tiger at the grass-roots level on spending and taxes. We are because there is too much confusing compromise on policy at the top in Washington. I cannot deny that we cannot be players in Washington without alternative proposals, and some balance must be found; but I know we cannot communicate with the grass roots if we give too much on principle in order to be practical. The grass roots simply cannot understand this. The groups that are most effective at the grass roots, like the National Right to Work Committee or the National Taxpayers Union (or Common Cause or Ralph Nader), generally play a less "practical" role.

Funding the Republican Party at the precinct level is not the answer. Although much money has been wasted by the Washington committees, it is not possible to rebuild the 19th-century political party. The direct primary finished that, and candidates are what politics are about today. The GOP should send more money to local parties to fund candidates, not to build party bureaucracies, which could not win elections with a billion dollars a month. I don't think anyone would leave the formulation of policy to the parties. Likewise, only an independent political action committee (PAC) could possibly do the electoral job for conservatives.

Finally, there is the problem of education. Mr. Feulner is rightly dismayed that there are no conservative universities, and few, if any, departments. But to hope for reform of the current institutions is to look for the impossible. He is right on target when he says that we must build new institutions. Mr. Meyerson coaxes from Mr. Feulner the self-description of "optimistic entrepreneur." I never could put my finger on what has made him so successful, but this surely captures it. Unfortunately, there are few roseate institution-builders like him, and almost none of them are conservative.

What Mr. Feulner's interview shows most is that the conservative movement's greatest need is for optimistic entrepreneurs to create new institutions to join his Heritage Foundation. For openers, we could use a PAC to do the job the parties used to perform and a top-rate university in Washington that could radiate its educational excellence across America.

Donald Devine
President
Donald Devine Company
Alexandria, VA

Some Confusion

Dear Sir:

At times, Mr. Feulner seems to confuse the Republican Party with the conservative movement. A political party is a group that supports the same set of candidates for public office. A political movement is a group that addresses a range of political issues from the same set of principles. In our political system, the Republican Party must be a "big tent" to maintain the presidency and broaden its representation in Congress and the state and local governments. No purpose is served by broadening the conservative movement to include people with quite different political principles; groups with different principles cannot resolve issues intellectually, even if they must deal with each other intellectually.

In response to two successive questions, Mr. Feulner contradicts himself, first denying that Heritage has joined "the Washington establishment" and then stating an objective to be "real players and participants in the Washington policy process." The problem, in such issues as child-care and medical care where the Left has defined the issues, is that any institute that offers a less bad solution to these issues is in complicity, if not full membership, with the Washington establishment. On such issues, it is far more important to try to change the mind-set that affects how an issue is perceived than to offer conservative technocratic solutions to policy issues that are defined by the Left.

One can hope that liberals will someday distinguish between a virtue and a requirement, and that conservatives will distinguish between a sin and a crime.
—William A. Niskanen

On several issues bearing on libertarianism, Mr. Feulner is merely confused. Hayek may have rejected the term "libertarian," but he also is the author of a famous essay on "Why I Am Not a Conservative." Conservatives and libertarians share the conviction that one of the few fundamental roles of the federal government is to "make the nation safe from external threats," and both support a missile defense system, at least against small attacks. Conservatives, however, must bear the burden of demonstrating how the ability to send a large military force to some distant desert or jungle contributes to our national security. Conservatives also agree that drug use is "socially destructive and socially unacceptable." Our differences on drug policy bear primarily on the issue of whether drug use or drug prohibition is more socially destructive, and whether behavior that is socially unacceptable should necessarily be a crime.

One can hope that liberals will someday learn to distinguish between a virtue and a requirement,

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

and that conservatives will learn to distinguish between a sin and a crime. Conservatives should be skeptical of a view that the federal government is the best institution to reinforce virtue or discourage sin.

William A. Niskanen
Chairman
Cato Institute
Washington, DC

Purism Is a Death Wish

Dear Sir:

I was pleased to see Mr. Feulner's emphasis on the shared values that exist, and should *prevail*, among conservatives. The recent acrimonious and misplaced intermural warfare among conservative groups is both uninformed and ill-advised.

I was also pleased that Mr. Feulner addressed the matter of conservatives and the power nexus. I was recently on a radio program with another conservative who lamented the corruption of the movement by its co-option into the bureaucratic rivulets of the Washington Leviathan. Surely this kind of purism is the conservative death wish. We seem happy to stand on the sides and mourn the passing of great eras or the dissolution of transcendent metaphysical principles. We revel in our irrelevance.

J. David Hoeveler Jr.
Professor and Department Chair
Department of History
University of Wisconsin
Milwaukee, WI

Edwin J. Feulner Jr. replies:

Donald Devine captures the main point of my interview when he says "that the conservative movement's greatest need is for optimistic entrepreneurs to create new institutions." Despite significant success in persuading public opinion that conservative ideas make sense, we have not built the institutions necessary to capitalize on this popularity and insure our long-term influence in the battle of ideas.

I think, however, that Mr. Devine is overly pessimistic about the utility of political parties in general and the Republican Party in particular. Certainly, the direct primary means that conservatives should devote much of their energies toward specific campaigns, but it doesn't mean that control over local party apparatuses is unimportant. There are still locales where the party bureaucracy has major, direct impact on the nomination process. Where nominations are determined strictly by primary, the endorsement by party leadership and the party's ability to provide volunteers and local political savvy and connections can still count for ongoing influence over the candidate once elected.

Party credentials are still a prerequisite for many political appointments. And building power bases at the local level is still a relatively sure way for conservatives to work their way up to national party leadership. Indeed, one reason the national Republican Party has been so reluctant to fund local party apparatuses is because many locals are more conservative and are viewed as threats by establishment Republicans. Finally, while I agree with Mr. Devine that one of our movement's greatest institutional weaknesses is our lack of effective PACs, Congress's threat to outlaw them suggests that political parties may be the only "PACs" we have left before too long.

Every political movement experiences tension between its purists, such as William Niskanen, who articulate an ideal position that may be the long-range objective but has no near-term chance of adoption, and its equally principled pragmatists who are just as committed to the long-term agenda but are also determined to achieve the best result possible in the meantime. Unlike Mr. Niskanen, I recognize the importance of both these approaches to the movement's success. If Mr. Niskanen had his way, we would today be coping with the immense federal-nanny bureaucracy the ABC child-care bill would have given us, rather than the relatively consumer-oriented bill we managed to achieve. Moreover, I do not confuse the Republican Party and the conservative movement as Mr. Niskanen charges; I merely recognize political parties as among the best means available for conservatives to achieve the best political results possible.

Mr. Niskanen's idea that members of a political movement presuppose "the same set of principles" is overstated. While there clearly must be much common ground of principle, there is also some room for disagreement. The extent of disagreement in principle we see between social and economic conservatives, and between neoconservatives and paleoconservatives, does not justify the bickering that has occurred, especially considering the different factions' actual public policy agendas, which have significant areas of overlap.

"Conservatives" are no less concerned than Mr. Niskanen about the distinction "between a sin and a crime." There are countless sins that social conservatives would never think of making criminal—lying, gluttony, anger, selfishness, *etc.* The difference is not that Mr. Niskanen draws the distinction and "conservatives" do not; the difference is where the distinction is drawn, and frankly, they are not drawn that far apart. Mr. Niskanen would do well to learn from Donald Devine's constructive reminder about Frank Meyer's formula for reconciling libertarianism and traditionalism. ☎

I estimate that I spend one-third of my time complying with government regulations.

—Donald Bradley

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

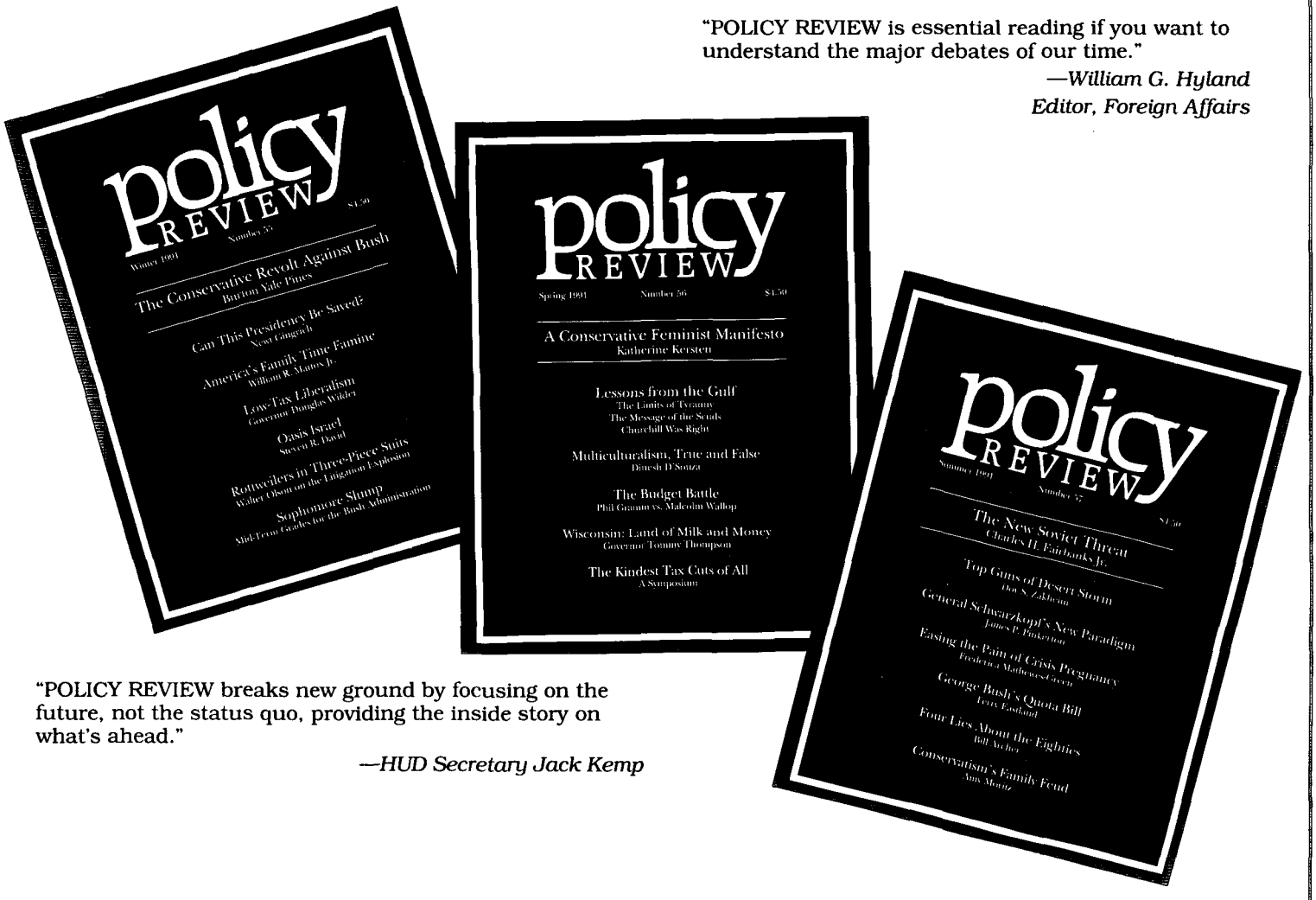
Conservative Thought At Its Best

"POLICY REVIEW is the most thoughtful, the most provocative, and the most influential publication on the intellectual right."

—Martin Peretz
Editor-in-Chief, The New Republic

"POLICY REVIEW is essential reading if you want to understand the major debates of our time."

—William G. Hyland
Editor, Foreign Affairs



"POLICY REVIEW breaks new ground by focusing on the future, not the status quo, providing the inside story on what's ahead."

—HUD Secretary Jack Kemp

Now available at special introductory prices—up to 22% off !

SSA92B

Name _____
(please print)
Address _____
City/State/Zip _____

☐ One year, 4 issues for $16 (11% off) ☐ Two years, 8 issues for $30 (16% off) ☐ Three years, 12 issues for $42 (22% off)

Begin my subscription: ☐ Current issue ☐ Next issue Payment Terms: ☐ Payment Enclosed ☐ Bill Me

Bill my: ☐ Visa ☐ Master Card ☐ American Express

Card Number _____ Exp. Date _____

Signature _____

Please make checks payable to: POLICY REVIEW, 214 Massachusetts Avenue, NE, Washington, DC, 20002. Add $8.00 postage per year for foreign air-speeded delivery.

POLICY REVIEW—the thought leader of American conservatism.

policy REVIEW

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

policy REVIEW

Talk radio turned private unhappiness into public tax revolt. A new megawatt FM radio station, billing itself as New Jersey 101.5, was attracting an adult audience with a catchy format of oldies rock and listener call-ins. The hosts of the afternoon time, John Kobylt and Ken Chiampou, savaged the Florio tax proposals, the Democratic legislators, and politicians in general. Soon the John & Ken show attracted a wide audience—on the beach, over the sound systems of small retail stores, and on afternoon commutes.

David Kehler
The Trenton Tea Party:
The Story of New Jersey's Tax Revolt

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED